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DECEMBER 2013

BREAKING THROUGH

THE EMERGING MANAGERS REPORT

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On Camera

Larissa Herczeg, Oak Street Real Estate Capital

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with Peter Braffman, Larissa Herczeg and Charles Purse

Backing the Emerging Manager: Thinking the Unthinkable

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Emerging Manager LPs : We Never Say No. We Might Say Not Now

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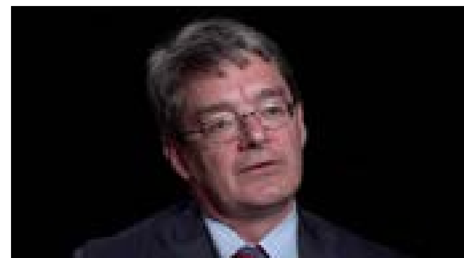
Single family REO is the last frontier in real estate, for Colony Capital CEO Tom Barrack .

Fundraising 'Continues to be Very Difficult'

With real estate capital concentrated in the hands of fewer GPs, Charles Purse of Park Hill Real Estate argues managers need to be relevant to the users of real estate, as well as their LPs.



Real Estate is About to Be Disrupted: Bentall Kennedy

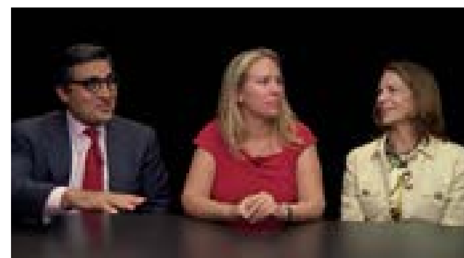
Real estate is about to be disrupted; interest rates, technology, demographic changes, according to Doug Poutasse of Bentall Kennedy.

The Meaning of LP Influence, Backing the Next Generation

People, not deals. WX Woman of the Year, Marjorie Tsang of NY Common on her proudest achievements.

Regulating FIRPTA

The White House has called for change to a 30-year-old tax on foreign investment in US real estate. Jeremy Naylor of Cooley warns GPs not to get too excited.



How Realistic Are You? Getting a Foot on the Ladder

Career experts discuss the challenges of breaking into the private real estate industry and how firms, large and small, view the universe of new recruits.

About PrivcapRE Special Reports

PrivcapRE Special Reports are exclusively for subscribers to PrivcapRE, the definitive channel for thought leadership in private real estate investment. Each month PrivcapRE focuses on a critical theme and produces a "bundle" of thought-leadership content in multiple formats—a digital report, video interviews and panel discussions, and audio programs. The market intelligence of leading authorities forms the core of each report.

PrivcapRE Special Reports help market participants better understand opportunities and practices in private capital, as well as gain deep insights into the people with whom they may become long-term investment partners.

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Jan 2014: Outlook 2014

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Privcap LLC
David Snow *Co-founder and CEO*
Gill Torren *Co-founder and President*
Matthew Malone *Editorial Director*

Content
Zoe Hughes *Editor, PrivcapRE*
Tanya Klich *Associate Editor*
Kathleen O'Donnell *Media Coordinator*
Cameron Faulkner *Media Coordinator*

Design
Allison Fleming *Art Director*

Contacts

Editorial
David Snow /
dsnow@privcap.com / 646.233.4558

Matthew Malone /
mmalone@privcap.com / 203.554.7261

Zoe Hughes /
zhughes@privcap.com / 917.355.3957

Sponsorships & Sales
Gill Torren /
gtorren@privcap.com / 646.233.4559

For subscriptions, please call 855-PRIVCAP or email subscribe@privcap.com

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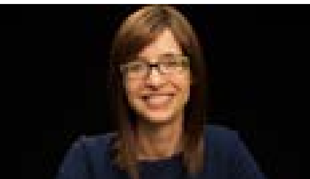
It's More than *Just* Real Estate

Emerging managers need to truly understand what it means to be a manager of institutional capital.



Market analysis by PrivcapRE editor **Zoe Hughes**

When thinking about making the jump to institutional investment management, it's natural to ask this question first: "Can I raise the money (and make loads of it)?"

But here's a better one: Do I have what it takes to be a good steward of someone else's money?

Now that may sound like a moot— or indeed, inessential— point, but it's critical. Raising a private equity real estate fund is not about corralling another source of capital for deals. When an operator-partner, developer, or even a spin-out group from an existing private equity real estate platform closes LP capital, they have to remember one simple but loaded word: "Fiduciary."

When you invest on behalf of institutional investors, be it for CalPERS or a small family office, you become responsible for generating returns for their benefit. Real estate is your product, but your business is being a manager of institutional investor equity.

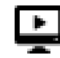
'Real estate is your product, but your business is being a manager of institutional investor equity.' -Zoe Hughes

And that doesn't mean merely tacking on reporting and compliance functions. It means a change in mindset. It means over-communicating, not necessarily in volume, but in quality. It means that your investors come first, and you second. Fundamentally, it means alignment of interest (however hackneyed that phrase has become) with your limited partners.

For LPs targeting emerging managers, the great advantage of being early investors is the ability to help shape that alignment, and to help guide the development and evolution of a firm's mindset and culture. By taking the time to do that today, you're equipping the next generation of managers with the skills to go out and raise capital more widely tomorrow.

It's sexier, of course, to focus on the bigger money that institutional fund management can command. But to survive as an institutional money manager, you must appreciate that with institutional money comes institutional responsibilities. You'll see more evidence of this in this special report. /

Are Emerging Managers Gaining Traction?



Click to watch this video at privcapre.com

Our expert panel explains the value of giving a promising manager a chance. With Larissa Herczeg of Oak Street Real Estate Capital, Peter Braffman of Credit Suisse Customized Fund Investment Group and Charles Purse of Park Hill Real Estate Group.

PrivcapRE: Larissa, is there actually any capital available for these younger GPs?

Larissa Herczeg: There definitely is. We would all like to see much more capital available, and there is certainly a lot of room for growth in the space, but for managers willing to endure a long fund-raise, there definitely is capital for them.

PrivcapRE: And Peter, does capital usually come as dedicated funds or through funds of funds?

Peter Braffman: Dedicated funds are predominant. While funds of funds occupy an important space, the largest capital tends to be plan sponsors who go direct, such as endowments.

PrivcapRE: Chuck, how would you define the landscape?

Charles Purse: If you ask the average small manager, they would say that no, there is not enough capital. A real tension is raising enough capital so that the fee stream is enough to support your business with continuing pressure from LPs to keep fees low. So while LPs want more reporting and better performance, the GPs need to compensate and maintain their staff. Some emerging managers give up too soon. Just 12 percent raise their targets, and 75 percent won't raise any capital at all, but it's about commitment to the cause.

PrivcapRE: So three-quarters of all managers don't get anything. Larissa, is that your experience?

Herczeg: A lot of [managers] haven't thought it through, and they just don't make the cut. A lot of them give up too soon, in my estimation. After six or nine months, they're ready to throw in the tow-

'For us to be serious about the emerging-manager space, we have to be doing co-investments, JV transactions, and providing seed capital.'-Peter Braffman

7 DEADLY FUNDRAISING SINS

It may seem silly, but even minor missteps made by an emerging manager can turn off LPs, according to our experts:

1. Not sending materials in advance when they're requested before a meeting.

2. Not following up regularly.

3. Answering phones during meetings.

4. Not doing your research before the meeting. Sometimes it's difficult to access information about certain investors, so start by requesting an overview from them.

5. Being inefficient. If the meeting was scheduled for an hour, then take an hour.

6. Skimping on information. In addition to providing a DDQ (due diligence questionnaire) and full performance history, tell them about your other strategies and businesses.

7. Overstating where you are in the fundraising cycle. Herczeg says: "If you tell me that Peter's ready to close and committed money to you, you should know that when you leave the room, I'm going to call Peter. And if he does not confirm that, we're both going to be upset."

The Panelists

Larissa Herczeg
Managing Partner
Oak Street Real Estate Capital

Herczeg is responsible for all aspects of Oak Street's Seeding & Strategic Capital business, including investment sourcing, due diligence, selection and portfolio management and reporting. Prior to joining Oak Street, Herczeg was responsible for global real estate investing at Morgan Creek Capital Management, including all aspects of sourcing, due diligence and portfolio monitoring and reporting. Herczeg received a BA with honors in Government and Economics from the University of Notre Dame, a Master's degree with honors in International Affairs from Columbia University's School of International and Public Affairs and a Juris Doctor degree with honors from Columbia University Law School.

Peter Braffman
Partner
Credit Suisse Customized Fund Investment Group

Braffman is responsible for CFIG's real estate sourcing and underwriting activities and is a voting member of the CFIG Investment Committee. Previously, He was a senior vice president at Zurich Alternative Asset Management, where he was responsible for sourcing, underwriting and executing U.S.-based real estate investments. He was also a Vice President in the Merger and Strategic Advisory Group at Goldman Sachs, where he advised corporate clients on structured real estate valuations, monetizations and dispositions of their directly owned and used assets. He holds an MBA from the J.L. Kellogg Graduate School of Management, a JD from the Northwestern University School of Law, and a BA in Biology and History from the University of Rochester.

Charles Purse
Senior Managing Director
Park Hill Real Estate Group

Purse, a co-founder of Park Hill Real Estate Group, is a member of Park Hill's real estate distribution team in New York. Purse has over thirty years of experience in the real estate industry. Prior to Park Hill, Purse worked in the Real Estate Private Fund Group at Credit Suisse First Boston. Previously, Purse was with DRA Advisors, Inc., a real estate investment advisory firm in New York City. He received a BS from Dartmouth College and an MBA from Northwestern University's Kellogg School of Management.

el. The reality is it takes longer than that, especially if you're a first-time fund. They may have to do deals in between. But they usually do have success. The numbers shouldn't be disheartening to those who are committed.

PrivcapRE: Here's a statistic: 65 percent of LPs would never consider a first-time fund. Does this shock you?

Braffman: I'm not surprised, but it's not necessarily a capital problem per se. It's a process problem for a lot of the GPs. Many come too early, without deep enough track records. A lot of them are fantastic investors, but they're not yet established as fiduciaries and managing other people's money.

PrivcapRE: Do you think investors are overwhelmed by a fear of the unknown? How do you overcome the perception of risk toward emerging managers?

Purse: It's difficult to help them get over negativity. There's a real chicken-and-egg issue in that. Many want to see you scale before they look at you, but how do you get to scale?

PrivcapRE: Do investors have concerns about infrastructure—that emerging managers just don't have the staff or capacity to go through the due diligence process?

Braffman: The truth is, underwriting a commingled fund is probably the most difficult thing, because it's a long lockup period. It requires a lot of trust. It's easier to look at a team with a very established track record. It takes more manpower to get to the smaller, newer funds.

PrivcapRE: So why should LPs look at emerging managers?

Braffman: The large national platforms are wonderful, but

'If you ask the average small manager, they would say that no, there is not enough capital.' -Charles Purse

you know what? It's much harder for them to invest in smaller assets. The only way to get that exposure is with small managers. And once you see the liquidity and the performance, it becomes interesting.

Purse: Decision-making is better at the real estate level with people who sign the leases and negotiate with the planning authorities. There was too much investing in the real estate world that was based on a business plan. Market conditions change. Objectives change. Tenant needs change. And so the ability to course-correct during the execution of a value-enhancement strategy is very important. And if you're in a business plan, it's very hard to course-correct without admitting that you made a mistake to your capital partner—even though you didn't make a mistake. So what we found is that local targeted managers generally will make better decisions associated with the real estate. They're more aligned with the result, and therefore you end up with better returns.

PrivcapRE: What's the reality of emerging-manager performance?

Herczeg: The track records and the historical performance over the past 10 years clearly show that smaller and newer managers outperform, and alignment issues explain that outperformance.

PrivcapRE: Is the rising tide of co-investment capital critical for newer managers who want to show LPs what they're missing? Are joint ventures and co-investments becoming more important as investors look at emerging managers?

Purse: We're working with a group on raising a small amount of capital, a relatively small amount of capital for a co-investment. They would go out and use that capital for an 80/20 JV, instead of a 90/10 JV with the deal-by-deal capital. So the amount of co-investment goes up, and that money that's in the pool shares is part of the revenue stream associated with the underlying capital. This is attractive to the GP because the co-invest capital is coming in on a deal-by-deal basis, and the GP capital is crossed across multiple deals. This allows the GP to have the benefits of a fund to go position a transaction or a portfolio, or buy a small piece in a portfolio and then escalate that piece later on. They can still also make returns on a deal-by-deal basis by doing the underlying laying off the bulk of the capital to deal-by-deal players.

PrivcapRE: Have your programs changed how they're allocating capital?

Braffman: We are. There are a few very good funds that are ready to be funds. There are others that are fantastic platforms that should be funds, but they're not necessarily ready. As fiduciaries, we can fund great deal flow and do fantastic deals with groups like that, but we can also help them establish a much deeper track record. So yes, for us to be serious about the emerging-manager space, we have to be doing co-investments, JV transactions, and providing seed capital. That's the direction we're going.

Herczeg: Our program has evolved similarly. The fact that there is not widespread emerging-manager programs and enthusiasm for emerging managers, you can't be the only one at the party. So oftentimes you're left waiting for other investors. /

EMERGING MANAGERS, THE TEXAS WAY

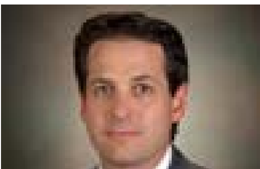
Why bother investing in emerging managers? Stuart Bernstein, head of the Texas Teachers' $2B EM program, explains how the pension allocates to the space, what they are looking for in EMs and why it presents such an attractive opportunity **by Zoe Hughes**

Why bother investing with emerging managers?

Consider the work involved—the sourcing, the vetting, the mentoring, the organizational risk. And with little conclusive data showing that new managers outperform experienced ones, it's no wonder that, by some accounts, 65 percent of LPs would never consider a first-time fund.

But even if just a third of LPs seek out emerging managers, that's a big number. Particularly when one is among the most influential investors in private equity and real estate: the Teachers Retirement System of Texas.

As a $111 billion public pension and one of the largest private equity and real estate LPs in the U.S., TRS "moves the needle" when it allocates capital, so it mostly deals with large funds. Its emerging-manager program gives it access to smaller opportunities that would otherwise pass it by. It also gives the pension fund the opportunity to influence the next generation of managers.



'It's the most exciting space there is. [It] is an opportunity to deliver alpha within a portfolio, negotiate LP-friendly terms, and build long-term relationships with a growing organization.'- Stuart Bernstein

Stuart Bernstein, the head of TRS's $2 billion emerging-manager program, says, "It's the most exciting space there is. [It] is an opportunity to deliver alpha within a portfolio, negotiate LP-friendly terms, and build long-term relationships with a growing organization."

In 2010, TRS made the deliberate decision to be "one of the best in the country" in investing with emerging managers , and backed that goal with cash. It more than doubled its allocation and expanded beyond traditional private equity to real estate.

TEACHERS RETIREMENT SYSTEM OF TEXAS REAL ESTATE EMERGING MANAGER PROGRAM

EM Definition: <$2bn AUM, raising 1st, 2nd, 3rd institutional fund

Commitment size: Typically $15m. TRS committment cannot exceed 40% of an emerging manager fund.

Recent committments include: Admiral Capital; Artemis Real Estate Partners; CityView; Hawkeye Partners; Integrated Capital; Pennybacker Capital; Savanna Real Estate; TriGate Property Partners

"It's our responsibility not only to look out for the best interests of TRS, but to act as a good steward to the emerging-manager space," Bernstein says. That includes negotiating LP-friendly terms that will benefit all investors, as well as mentoring managers in being a good fiduciary. "It's about making them institutional quality and ensuring comfort in the marketplace."

But can smaller funds do it?

Of course, not every LP has the resources of a TRS. The fund invests, either directly or through funds of funds, in 108 private equity and real estate emerging managers. Bernstein manages the program with two other full-time investment professionals, Krista Kerr and Andrew Cronin.

Continues on the next page

EMERGING MANAGERS, BY THE NUMBERS

HOW LPs DEFINE "EMERGING MANAGER"

INSTITUTION	EM AUM	EM FUND #
Texas TRS	<$2B	<3
Texas ERS	<$1B	<3
Illinois Emerging Manager Real Estate Consortium*	<$3B	No Limit
New York Common	<$1B**	<3

*Includes the Illinois Municipal Retirement Fund, State Universities Retirement System, and the Public School Teachers' Pension Fund of Chicago
**$1B in equity under management: as defined in New York Common / Artemis RE Partners separate account common.

254

FIRST TIME FUNDS IN THE MARKET GLOBALLY
Source: Oak Street and Preqin, as of 10/22/13

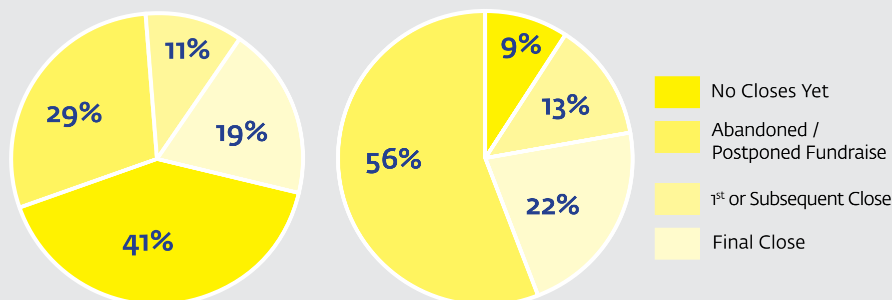
LA Fire + Police
1992 THE YEAR THE FUND LAUNCHED AN EM PROGRAM

481

EMERGING MANAGERS IN THE MARKET GLOBALLY
Source: Oak Street and Preqin, as of 10/22/13

REAL ESTATE EMERGING MANAGER FUNDRAISING OVERVIEW

19% of the approximately 400 emerging manager funds surveyed in this analysis have reached a final close. Approximately 70% of funds have not raised any capital, and 29% of funds have abandoned or postponed their fundraise (primarily first time funds).



Source: Credit Suisse Customized Fund Investment Group

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TRS Continued

But it doesn't take dedicated programs or a set slice of the portfolio pie for new managers to succeed. Other investors told PrivcapRE that while they don't specifically target emerging managers, they are open to assessing such opportunities when they arise.

Today, competition is the enemy of the emerging manager. Between 2010 and 2012, there was a 50 percent drop in the number of first-time funds closed. Oak Street Real Estate Capital figures show capital raised as a proportion of total real estate fundraising falling from 18 percent in 2010, when emerging managers closed on $8.1 billion of capital, to 11 percent in 2012, when that figure fell to $6.6 billion. The last time the industry saw levels drop to 11 percent was in 2008, when 72 emerging managers raised $15 billion of equity.

So with more than 480 managers currently clamoring for LP money, the challenge for aspiring managers is to be heard above the capital-raising roar. /

EMERGING MANAGERS AND FAMILY OFFICES: ONE LPs STORY

As one family office investor explains, a preference for fewer GP relationships and a crowded fundraising field make it even harder for new managers.

"If you are looking for the best opportunity, there's only going to be so many of them," says the manager of one New York–based family office. "Will emerging managers make their case better than others? There's a lot of noise in the market, and part of our job is to see through that and not let the marketing spend or lack thereof drive the decisions."

In addition to visibility, smaller managers are also victims of the desire among LPs to manage fewer GP relationships. The family office LP says it targets allocations of between $30 million and $50 million, splitting its commitments between funds, third-party platforms, and direct deals. At best it invests in just a few every year. "The desire is to have a more concentrated portfolio with a fewer number of managers. It's tough sometimes to back folks only raising a small fund."

CAPITAL COMMITMENT ROUNDUP

$100M ALLSTATE INSURANCE

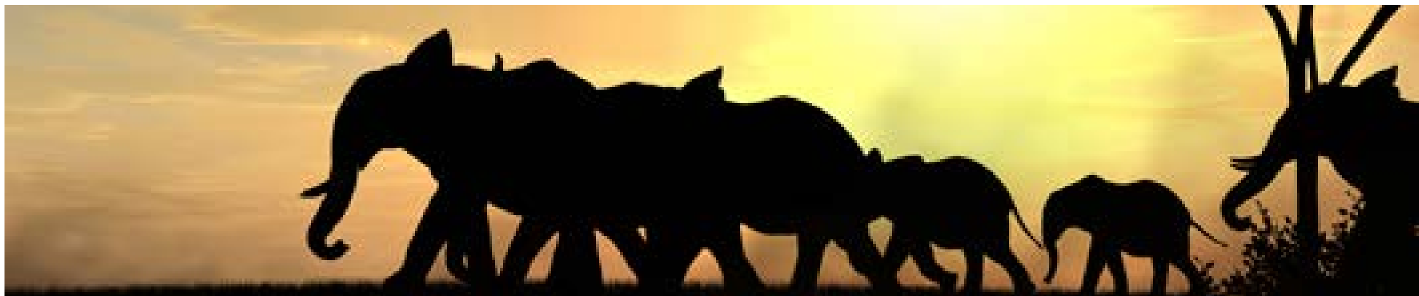
$175M ILLINOIS REAL ESTATE EMERGING MANAGER CONSORTIUM

$200M CalPERS

$600M NEW YORK COMMON

By **Zoe Hughes**

Tale of Two Emerging Manager Programs



Two of the largest public pension plans in the U.S., **CalPERS** and **New York Common,** have launched alternative programs to target the real estate emerging manager space: separate accounts sourcing programmatic joint ventures with up-and-coming GPs. Run by Canyon Capital and Artemis Real Estate respectively, the two programs are very different; what brings them together is a focus on mentoring.

Canyon: California Catalysts

When Canyon Capital Realty Advisors won the separate account to build the real estate emerging manager program on behalf of the California Public Employees Retirement System (CalPERS), one of their main responsibilities was to provide mentorship to fledgling institutional money managers. That's a capability better handled, perhaps, by a smaller, dedicated GP than a large public pension.

"The mentoring is very individualistic," says Maria Stamolis, managing director at Canyon and head of the $200-million Canyon Catalyst Fund, which houses the CalPERS' emerging manager investments. "In each case we are providing guidance and support to the partner and their team. In addition, we provide perspective on the structuring of the investment as well as guidance on the business plans for the assets."

Even with a specific mandate to "develop" the new managers, Canyon was required to choose candidates who were already successful in their existing field, and self-sustaining. The CalPERS capital was about aiding 'transition and transformation' of the next generation of real estate investment managers. It was not about "survivor" capital.

The Fund

Canyon is focused on finding the best operators, developers and early-stage investment managers who hope to invest on behalf of one of biggest names in the institutional real estate world. There's one important caveat: the managers must all be based in California.

Theodore Eliopoulos, senior investment officer for real assets at CalPERS, said in December 2012 that the California-only rule was a deliberate "walk before [you] run strategy." Over time, and with success, he said, the pension would look to grow beyond the state's borders.

Stamolis says the goal on the front end was to cast a "very wide net" in sourcing managers for the programmatic joint venture account. Roughly 225 managers were identified at the start of the program in late 2012, a number that was reduced to 55 once the California filter was applied. Preliminary negotiations were conducted with 12 prospective managers. Four were ultimately selected and received, in total, about 25 percent of the fund.

Each manager has been allocated between $30 million and $50 million of equity. With leverage limits, that translates into a possible $60 million to $100 million of purchasing power per manager.

Ensuring Success

The four selected managers —Pacshore Partners, Paragon Commercial Group, Rubicon Point Partners and Sack Properties— have different focuses. Rubicon and Pacshore target office, mixed-use and data centers in Northern and Southern California, respectively. Sack targets multifamily throughout the state and Paragon focuses on retail development and redevelopment, particularly grocery and community retail, across California.

"It's very specific," Stamolis says of the investment criteria. "If there's a product type similarity [between the managers], there's no geographic similarity. Managers need to be focused on specific product types and investments that are accretive to the goals of the fund and especially to CalPERS."

In supporting these managers, Stamolis says, "You have to be able to respond and provide specialized guidance depending upon where each manager is in their own company's life cycle, taking into account the goals of fund." For some, the focus is on establishing and enhancing back office capabilities; for others, it's executing on a growth plan or developing support for their pipeline.

It's also about exposure to the institutional real estate ecosystem, including introductions to lenders and brokers. "The CalPERS' seal of approval brings a level of credibility that has augmented the managers' ability to transact," Stamolis adds.

Continues on the next page

CAN IT WORK?

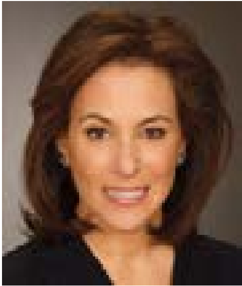
For all the benefits a relationship with CalPERS can confer, some concerns have been raised that, as a programmatic JV, the management fees won't offset the cost of compliance with CalPERS' reporting standards.

As one former CalPERS' manager said at the December 2012 workshop, the reporting, asset management and organizational investment needed to come up to CalPERS' standards can cost anywhere between $100,000 to $1.5 million. "Because the worse thing in the world is to give someone just enough money for them to go out of business," he said, according to a transcript.

Stamolis understands the challenges facing emerging managers, but adds: "Working for CalPERS does require a high level of compliance and reporting, and everyone understands that going in. The fees are there to cover the resources needed to source and manage the investments of the fund. You morph your reporting to your investors' needs."

Artemis: One Size Does Not Fit All

Two years into their emerging manager investment program, Artemis Real Estate Partners co-founder Deborah Harmon is as passionate about the space as when she first secured the mandate from the New York State Common Retirement Fund.



Deborah Harmon

"It's our responsibility, along with other like-minded firms, to change the face of the real estate industry," Harmon says literally.

In investing the $300-million separate account from New York Common, Artemis has kept a focus on diversity and ownership structures. In sourcing potential managers for its program, Artemis developed a database of more than 300 emerging managers, of which 13 were ultimately selected and received allocations of up to $50 million each. Nearly 80 percent of the managers are minority and women-owned businesses, and all are targeting core-plus strategies, across product types and the country

"We are seeing new emerging managers every day with a wide variety and diversity of firm ownership, strategy and experience," Harmon says. "In our experience, when you invest with emerging managers you can improve the diversity [of your portfolio] and, most importantly, the bottom line. Emerging managers often have an unparalleled will to succeed."

Early focus

What makes the program most unique is that Artemis and New York Common are targeting core-plus investing. That focus is something that Harmon says few, if any, other emerging manager programs share. "While taking a bit less risk on the asset, we can provide more help and take more proportion risk with the manager," she says.

Of the 13 selected emerging managers, two are start-up firms, says Harmon. Artemis is helping the firms' senior executives, who are spinning out from larger organizations, build their teams and infrastructure.

Of the remaining managers, Artemis has targeted established operators and early-stage investment managers to pursue core-plus joint ventures. Among them are Ellis Partners, which is targeting office, industrial and retail in San Francisco's Bay Area; Primestor Development, which is developing a retail JV with Artemis in California; and Capstone Development, which is targeting hotels across the US.

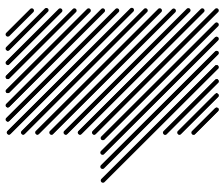
"Our general counsel provides significant mentoring on compliance and our CFO and accounting team facilitate lender introductions. Our portfolio managers oversee our managers, acquisitions and work with the New York Common team, and I focus on providing strategic business development advice" Harmon says.

And that's the key to any emerging manager investing for Harmon: "There is no one-size fits all approach," says Harmon. Especially not for programmatic JVs.

Harmon readily acknowledges that LPs such as New York Common., TRS and CalPERS have been influential in investing and promoting the emerging manager space. But more is needed, she says. "It is critical to increase the access to capital to open the doors for the next generation of real estate investment managers." /

By **Tanya Klich**

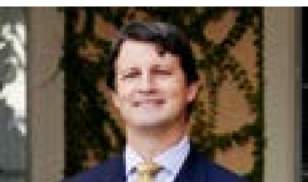
Lessons Learned: An Emerging Manager Survival Guide



As emerging managers take that giant step of becoming institutional investment managers, many discover that the reality is not as glamorous as the dream. Three emerging managers, **Jackie Brady, Ward Fitzgerald and Todd Minnis,** discuss what it takes to survive the fundraising trail.

After years of being the operating partner to a real estate allocator fund, you can understand why many would want to cut out the intermediary. In a world where investors are eager to invest directly at the asset level and get closer to the real estate, why shouldn't operating partners become institutional fiduciaries as well?

By some accounts, there are more than 400 reasons not to. That is, more than 300 other emerging managers who are also trying to raise capital in a very competitive market. The going is not tough—it's downright brutal for anyone considering a career as a private equity real estate GP.



'To be a good investor is only 30 percent of the equation.' -Todd Minnis

PrivcapRE spoke to three emerging managers—all at various points of the emerging-manager life cycle—on the realities of striking out on their own and what it takes to succeed today.

"It takes an amount of tenacity and perseverance to keep an honest dialogue with investors," says Ward Fitzgerald, CEO of logistics specialist Exeter Property Group. And he isn't just talking about the fundraising process, either. From raising capital to reporting, recruiting, and retaining talent and being the best fiduciary you can be, taking that step into the institutional real estate investment world can be more like a giant leap.

Fundraising the Emerging-Manager Way

Todd Minnis, CIO of Cypress Equities, says that before even thinking about raising money, a new manager has to determine which LPs have capital to allocate to their niche strategy. Minnis, a retail specialist, says: "Being that first-time manager and sector-specific can be limiting, because you don't know who has capital for this space."

When Cypress started fundraising last year, investors were just beginning to return to retail. "We had a successful raise, but that takes a lot of good meetings," adds Minnis. "[But] I'm glad we went through it, because having our own discretionary capital targeting our sector has changed our business."

Ward Fitzgerald of Exeter Property Group says that being an integrated operator has its benefits, but a downside is a narrower pool of potential investors. "It limits our universe and constrains growth. The likelihood of raising $1 billion to $2 billion is remote; our story is more in the $400 million to $800 million range. We're comfortable with that."

Jackie Brady, the former manager of BNY Mellon's debt platform, explains that the debt niche is "a strange animal" for many LPs. In some firms it operates as fixed income; in others it's real estate.

The Emerging Managers

Ward Fitzgerald,
Managing Principal & CEO, Exeter Property Group

- Founded in 2006, targeting warehouse & logistics
- Closed Fund I of $357m, 2007
- Closed Fund II of $615m, 2012
- Based in Plymouth Meeting, PA

Todd Minnis,
CEO, Cypress Equities

- Targets multi-tenant retail
- Debut institutional fund launched 2012
- Reported second close of $335m, Oct 2013
- Based in Dallas, TX

Jackie Brady,
Managing Principal, Canopy Investments

- Team spin out from BNY Mellon in 2011, managing legacy debt fund
- Formed debt platform with Carlyle, Oct 2013
- Based in Plymouth Meeting, PA

Although the firm had a pretty good sense of potential partners, she knew Canopy would need to broaden its network to raise money.

By the end of 2012, her team structured a commingled mezzanine debt product, but the market tightened. By October 2013, Brady had adapted its strategy and agreed to a JV partnership with The Carlyle Group, originating loans between $5 million and $15 million.

Surviving LP Due Diligence

However, fundraising is only a fraction of the battle. Once you've gained traction, then comes the due diligence and fee negotiations. "It's similar if not worse than running for political office," Minnis says.

"We can't compete with KKR or Carlyle, because they are on Fund X and have built their platform. The key is to be transparent with your budget," Minnis continues, explaining: "Investors want to know everything, and you have to be prepared for it. As an emerging manager, I can't commit $50 million of my own to the fund. So to justify your fee, you have to set your budget on the table."

Fitzgerald explains it's a case of being honest. Very honest. "You have to be upfront about your personal bank account, car, and address. It does resonate with investors."

Communication, Communication, Communication

But key to all the capital raising, diligence, and negotiations is reporting and how an emerging manager communicates with investors. Brady, Fitzgerald, and Minnis all agree that good communication will help a first-time fund manager make it to Fund II.

Fitzgerald warns other emerging managers that its senior executives can't just focus on the investing side and overlook investor relations: "We got good advice when we started about spending senior executive time [on reporting]. Senior executives have to commit thought to those relationships."

'We want them to understand how the debt markets function when we well know this product doesn't fit their needs yet.... But when it becomes more attractive, we want to be on their radar.' -Jackie Brady

He continues: "It's a bit clichéd, but when you get discretionary capital, investors trust you a great deal and you need to give complete transparency, integrity, openness."

And for many investors, they'd rather be told too much than too little, according to Minnis. "We got positive feedback because we reach out a lot. Investors want to be exposed and understand the space, so we tend to overcommunicate."

Brady agrees and argues that these values must be ingrained in the firm's culture. Approaching clients as partners instead of customers is critical to enriching any relationship, she explains: "You should inform them of things beyond what you can give them. Tell them about what you're seeing in the market, even if you can't do it in the portfolio."

In 2007, for example, the Canopy team saw an opportunity to short CMBS. The move was prohibited in the fund they were managing at the time, but Brady encouraged investors to pursue the opportunity with other players.

In 2008, her team had no qualms about informing investors in the BNY Mellon legacy fund to expect heavy losses. It was before the Lehman Brothers meltdown, when many LPs couldn't fathom the depths to which the market could drop, and many investors had never witnessed this level of honesty.

'It's a bit clichéd, but when you get discretionary capital, investors trust you a great deal and you need to give complete transparency, integrity, openness.' -Ward Fitzgerald

"We told several investors they could wear rose-colored glasses," Brady recalls, "but we won't."

And Communicate Some More

Brady advises keeping yourself on the investor's radar. In 2012, Canopy met with several endowments they knew wouldn't invest right away.

"We want them to understand how the debt markets function," she says, "even though we well know the product doesn't fit their needs yet.... But when it becomes more attractive, we want to be on their radar."/

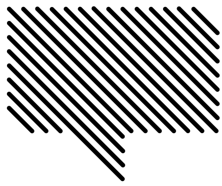
RETAINING EMERGING TALENT

For emerging managers, assuring LPs that the team is stable from top to bottom is a critical component in proving you have what it takes to grow—and succeed.

Minnis says the improving job market has made recruiting and retaining talent more challenging: "Mobility in the workforce is back again, and as a consequence you now need to be more competitive about salary and bonus structures."

Location can help a firm, according to Brady. Hers is located outside Philadelphia, where a less-competitive salary is more manageable than in a New York City office. Canopy also provides flexible schedules and made employees happy by declaring the first Friday of March Madness—the highlight of the U.S. college basketball season—a company holiday.

Fitzgerald argues, though, that it's also about growing a firm that is sustainable even when change does come. "We are not going to put our partners in a position where one individual can put the organization at risk," he says. "This firm can't fall apart because of opportunists."



Experts Weigh In

Perspectives on the emerging manager landscape

Katherine Giordano

Michael Hoffmann

Carmen Heredia-Lopez

Jack Foster

Understanding Your Partner

JACK FOSTER

Head of Real Assets, Franklin Templeton Real Asset Advisors

"When you begin to think about it, your biggest risk is not necessarily the market opportunity, it's who your partner is in those markets. This is something we really have to focus on. We love meeting with junior people on teams because we get a little insight that we may not see in other areas. It's very important to look at the fund across, not just the legal structure and negotiating terms, but really understanding the people, their commitment to the business longer term."

Reaping The Rewards

KATHERINE GIORDANO

Head of Americas, Property Multi-Manager, Aberdeen Asset Management

"To simply say that emerging managers create alpha is probably way too broad. Many will discover they are not meant to be institutional money managers. But others are. So there's no hard and fast rule that says focusing on emerging managers will automatically enhance your performance."

In Search of Diverse Managers

CARMEN HEREDIA-LOPEZ

Director of Investments, Chicago Teachers' Pension Fund

"Diverse managers play a role in optimal expected returns because they bring in new viewpoints, which I believe reduces risk in the portfolio."

When LPs Wield Bargaining Leverage

MICHAEL HOFFMANN

President, Probitas Partners

"The real challenge for emerging managers is not about chasing available capital, or proving their backgrounds as operators and investors – their biggest obstacle is transitioning to a fiduciary role. In this increasingly regulated world, getting an RIA stamp is basically a receipt for a future audit, which will dictate whether you meet compliance requirements. So emerging managers have to do their homework. They have to make sure that the managerial systems and processes are in place. But more importantly, they have to make sure they're culturally cut out to be a fiduciary, not just a deal shop."

Capital-Commitment Financing

Experts explain the benefits of a subscription-finance tool for fund managers

David Wasserman, SMBC, and Albert Tan, Haynes and Boone

THE BENEFITS OF BRIDGE FINANCING

Albert Tan, Partner, Co-Chair, Global Capital Commitment Financing Group, Haynes and Boone

Private equity funds, particularly real estate private equity funds, use subscription, or capital, commitment financing as a form of bridge financing to satisfy the investment and business needs of the fund. They can use this particular facility – where the collateral is secured not by the assets of the fund but by the capital commitments of the investors – as near-term financing in lieu of calling capital from their investors during the life of the investment period of the fund. The biggest benefit is the fund is able to use it for all of its business needs: payment of fees, expenses, and defaulting investors. It can pay for other borrowings that the fund may have for other subsidiaries. The facility can be used to bridge all of that.

COMMITED CAPITAL COMMUNICATIONS

David Wasserman, Executive Director, Real Estate, Sumitomo Mitsui Banking Corporation

There are a lot of different structures and vehicles, but we estimate its size at slightly over $100 billion. The market right now is very liquid. Many banks are returning to the space, particularly money center banks from Asia and Europe.

It prioritizes the same concepts as any other debt facility, including communication between the lender and borrower and understanding their needs to get comfortable providing the credit. With the growth, we've seen both lender's counsel and borrower's counsel become very educated on the product. And as lenders, I don't even have to ask for these provisions to be kept in the limited partnership agreement anymore. They're automatically included because borrowers' and lenders' counsel just become more knowledgeable about the process.

TIME IS OF THE ESSENCE

Jeffrey Tucker, COO, Century Bridge Capital

The GP's right to make capital calls on the investors is no longer just a nice feature for a firm. It's now a necessary tool for a fund like ours. We have LPs all over the world and we're closing investments in China. When we issue a capital call in this market, there's a 10-business day period for everybody to fund their capital call. Then there's an additional step: money generally comes into Hong Kong or Singapore before it's converted into RMB.

In a recent project we were closing, the joint venture documents and the contracts were signed about four days before a government-imposed deadline when the capital had to enter China. In that scenario, there would be no way that we could fund the capital on time by issuing a capital call to our investors. So we used our subscription line, and then issued the capital call to our investors. /

Expert Q&A /

Click to watch this video at privcapre.com

Expert Q&A with **Albert Tan,** Partner & Co-Chair, Global Capital Commitment Financing Group, Haynes and Boone

Albert Tan, Partner | **email:** albert.tan@haynesboone.com **Web:** www.haynesboone.com

How did Haynes and Boone develop a specialty in capital-commitment financing for private funds?

For the past quarter-century, we have had the largest full-time, dedicated practice group in capital commitment subscription financing. Our team of attorneys have represented lenders and private equity funds in North America, Europe, and Asia. It has recently migrated to Latin America.

Our firm has witnessed the evolution of the product since its inception, when it was used as a simple facility for one U.S.-based real estate private equity fund. It has since become a second-nature product for real estate funds, and we see it slowly moving to infrastructure, buyout, energy, and maritime funds.

The Haynes and Boone database contains analytical credit information for thousands of investors, with linkage to their ultimate credit source. Our database is also full of precedent documents due to our experience as lead administrative agent in key transactions worth over $20 billion.

The multi-disciplinary approach satisfies the interests of all the investors, the funds, and the lenders. /