

# DAS INVESTMENT.COM

## Secondary market real estate funds: “Price expectations drift sharply apart”

Michael Siefert, Managing Director at Madison Real Estate, on current developments in trading closed secondary market real estate funds



**Das Investment.com:** How is the secondary market for closed real estate funds doing at the present time?

**Michael Siefert:** As we see it, the need to be able to sell shares prematurely continues without interruption. In addition to the general demand for liquidity in the secondary market, a good number of investors are looking for an exit scenario forced by the financial crisis. On the other hand, the dislocation of international capital markets imposes a special challenge in determining prices.

**Das Investment.com:** Does that mean that the price expectations of sellers are unrealistic?

**Siefert:** I would not express it quite that strongly, yet we see frequently a sharp divergence in terms of price expectations. While sellers looking for liquidity assume a short-term recovery and stabilization of values, buyers are forced to make adequate allowance for the negative impact of the crisis on leasing, financing and investment markets in arriving at price determinations. Since the start of our business in secondary markets in 1996 we never had so many buying opportunities as we do now. We are being offered numerous funds that feature enticing purchasing opportunities – many however do not measure up to our quality requirements.

**Das Investment.com:** Where do you commit?

**Siefert:** We focus on high-value office buildings in good locations occupied by solvent tenants. At these locations we continue to see good opportunities. Such sites are particularly found in London, but also in 24-hour cities in the United States, such as New York, Boston or Chicago. Major German cities are also attractive. In our view some real

estate classifications may have been more affected by the crisis than others. Therefore we tend to be more reticent in considering hotel funds and retail properties.

**Das Investment.com:** How do you figure the actual value of a participation?

**Siefert:** The successful acquisition of fund shares requires deep-seated know-how both of the real estate and fund business. We rely merely on our own expertise. To put a value on a share we look at the original sales prospectus, a current annual report as well as the partnership agreement. To prepare our offer we analyze the property and current financial statements. In addition we consider yearly payouts and the anticipated remaining period of operation. The track record of the fund initiator and his strategy are final elements of our evaluation.

**Das Investment.com:** In what range do your buy offers fall?

**Siefert:** Typically between 70 and 140 percent of the original nominal investment. In the case of closed real estate funds we strive for a total investment of five million US dollars and up. However, frequently we begin with much smaller shares that in the course of time are supplemented by additional purchases of other participations. Overall, most of our investments total between 5 and 75 million US dollars.

**Das Investment.com:** Do you encounter occasionally, as in shipping markets, a competition for attractive shares among the bidders?

**Siefert:** Most likely, no. Many buyers of real estate shares have withdrawn from the market due to current market conditions – or they themselves have been affected by the crisis so much that they lack the required capital resources to buy more participations. Madison is actually one of the few buyers in the secondary market right now with enough equity to participate in the large volume sector. Nevertheless, we invariably look for minority participations and see ourselves primarily as a passive financial investor.

**Das Investment.com:** There was a case however which took a somewhat different course. You acquired a majority of shares from Falk 77 with the goal to restructure the fund. What was the background to this undertaking?

**Siefert:** With Falk 77 we analyzed its real estate holdings and that led to the sale of the Cologne office building from the fund. Secondly, we supported Nachmann, the temporary bankruptcy trustee, and Euro Asset Management, the Bilfinger-Berger subsidiary, which had assumed management of the fund, in negotiating settlements with creditors and shareholders. At a shareholders' meeting held in August 2007 a restructuring plan was presented and ultimately signed and sealed.

**Das Investment.com:** How did the creditors fare?

**Siefert:** In the meantime they have been satisfied. Moreover, the purchase of 84 percent of the shares by Madison led the Municipal Court in Munich to withdraw the temporary

bankruptcy proceedings. In brief: We returned the fund to a solid basis. It will continue to be managed actively by EAM.

**Das Investment.com:** Do you expect other funds to get such treatment?

**Siefert:** What made the Falk Fond 77 transaction distinct was the fact that the problem was a not a real estate matter, but purely a balance sheet problem. It is conceivable that we might commit to similar situations in the future. However, most distressed funds are impacted by real estate issues.