

Madison makes a secondary market in LPs

*The strong growth in the number of real estate limited partnerships in the Dutch market has created new problems. The liquidity in participations of these property vehicles is far from ideal and investors' capital is tied up for many years. New York based investment firm, **Madison International Realty** has responded to this development by acting as a liquidity provider for Dutch investors. Madison is bullish about the opportunities in The Netherlands.*

By Rogier Hentenaar and Sybe Nijboer

The global growth in closed-end non-listed real estate vehicles has also increased the need for liquidity in this part of the investment market, says Ronald Dickerman, President of Madison; "Investors can have many different reasons why they would like to sell their participations. For example; due to personal reasons, where liquidity is needed quickly. Or if they decide to change the composition of their investment portfolio. Another reason could be their decision to invest in another interesting investment opportunity for which they need to have capital available rapidly. With non-listed closed-end real estate vehicles, investors can not sell their participation easily during the fixed life of the fund. In these circumstances we can buy the participation from the investor, and the knife cuts two sides. The investor gets his money back and the fund can continue."

Dickerman was recently in The Netherlands for two days together with his German colleague Michael Siefert. They met with General partners of Dutch real estate syndicates. Madison is being advised by Chris Nicolle and Maarten Thissen of DTZ Corporate Finance from London. The Amsterdam office of law firm Greenberg Traurig is advising Madison with regards to the acquisition of the participations. During the two days meetings were held with ten syndicators. Some of those syndicators are very interested in Madison's concept to act as a liquidity provider for their investors.

Liquidity Provider

Madison has been active for nearly 10 years in the United States and opened an office in Frankfurt four years ago where Siefert assists German investors with illiquid real estate investments in the US, Germany and recently, in The Netherlands. Madison is mainly focused on private investors in real estate but also on institutional investors that have illiquid participations in real estate vehicles, joint ventures and other syndicates. As a liquidity provider, Madison creates a secondary market for real estate participants for which there is no official trading floor available like a stock exchange. "Especially given that the indirect market of non-listed real estate vehicles is continuing to grow", says Nicolle of DTZ Corporate Finance. As with a private equity company, Madison acquires stakes in a large number of real estate vehicles. From that perspective Madison can be seen as a kind of 'fund of funds'.

Madison invests in interests within a broad size range. The invested amount that Madison commits can be between \$ 1 mln and \$30 mln USD per investment, and the preferred remaining life of the individual interests is between circa three to five years. That size of commitment might be rather high given that the fund size – including the debt – of Dutch real estate limited partnership is often not more than 30 million euros. But according to Dickerman it is not a problem for Madison to invest a smaller amount than \$ 1 mln in a limited partnership. Dickerman also makes it clear that Madison only invests equity.

No fixed allocation

Does Madison want to create a specific sector allocation in its portfolio? "No, there is no fixed allocation. We invest in all types of real estate such as offices, retail, industrial, multi family and hospitality", says Dickerman. Madison focuses on real estate in the US and Europe that can easily be valued. Up to now most of the assets that Madison has provided *equity* for are in the US. Overall Madison has invested a total of \$225 million of equity of which approximately \$50 million is in Germany and the rest in the US. Dickerman: "Besides Germany we are looking in Europe at the Dutch and UK markets, because of the professional and mature nature of these markets." In The Netherlands Madison has started to talk to Dutch investors that own tickets in limited partnerships with income producing assets in the United States. Risky development projects are not the typical kind of assets Madison would look at.

Contact with participants

The question is how Madison knows where to find investors that are willing to sell. In order to find selling investors Madison has made contact with financial and legal advisers, banks and surveying firms: all those

parties that do business with investors on a daily basis. When Madison likes a real estate limited partnership, Madison will purchase a few participations directly. “In that way they grow the relationship with the so called *sponsor*, or manager of the fund”, says Nicolle.

After becoming an investor in the fund, Madison improves its network and contact base because of the established relationship with the fund manager. In this way, Madison will know relatively quickly which participants want to sell their interests in the fund. When this is the case, Madison will be advised by Greenberg Traurig. The transfer of participations in a real estate limited partnership is strictly regulated. In most cases all other participants will have to give written permission before any transfer can happen. Greenberg Traurig has developed a *concept* in which a quick transfer is legally executable.

Besides the fact that Madison does not have a fixed sector mix, it also does not limit itself to a maximum size of the stake it will acquire in a fund. That can vary from the transfer of 3% with a value of \$ 1 mln in two office buildings in Houston belonging to Deutsche Bank, to more than 45% interest (\$ 5,4 mln) in a retail and entertainment complex in Denver that has been taken over from Rosche Capital Corporation.

An issue that is always difficult to avoid is how Madison appraises the value of the participations on offer. Dickerman: “We focus on the time till liquidation of the fund when the properties are sold. But we also look at the quality of the real estate such as the location, the real estate itself and lease contracts. Sometimes we calculate a discount to the price if there are uncertainties or if there is an urgency for the liquidity, but there are also instances where we have offered a premium if we believe that there is a good prospect for profit in the medium term.”