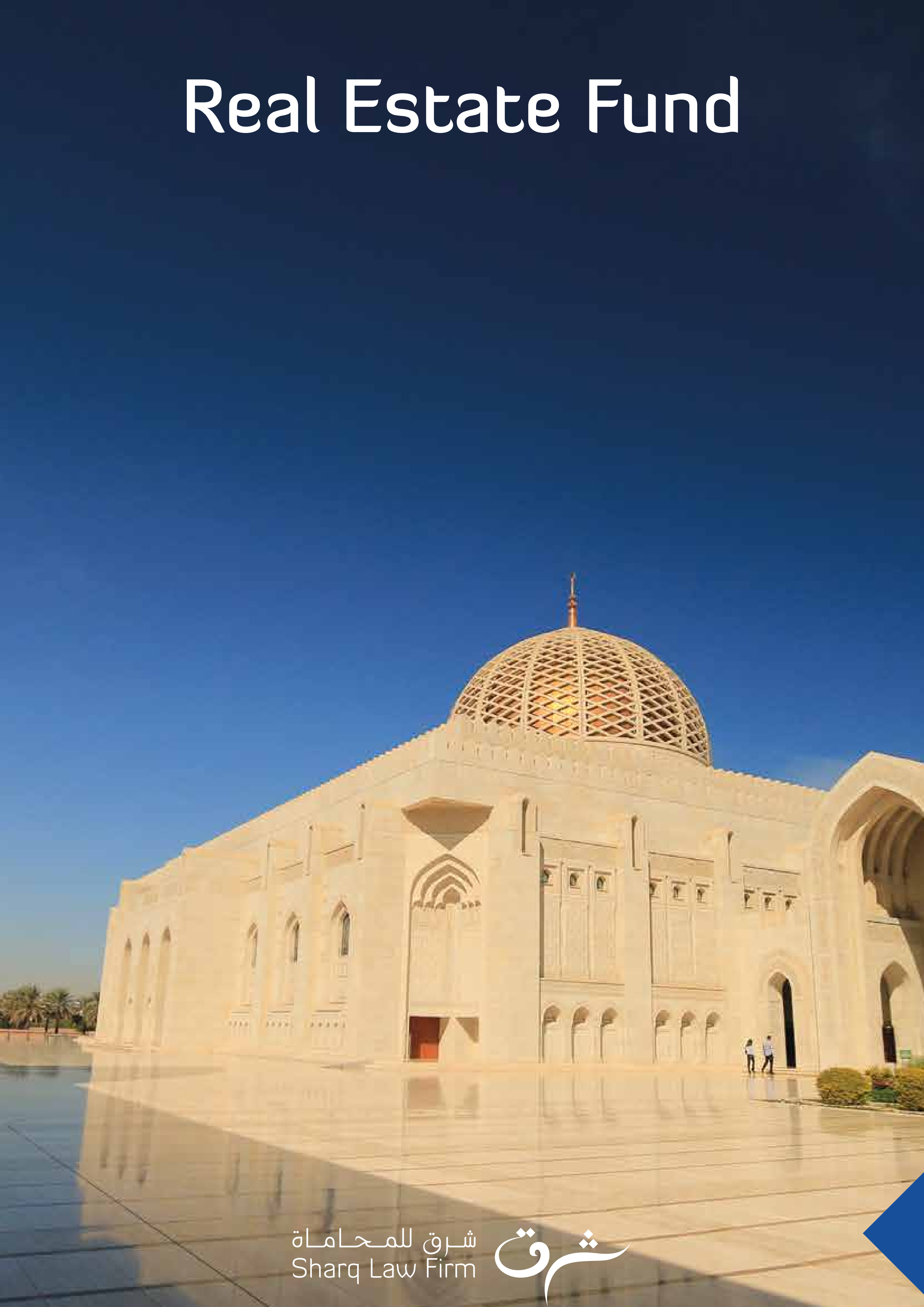
Real Estate Fund



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What Is a Real Estate Fund?

A real estate fund is a professionally managed portfolio of diversified real estate holdings. Most real estate funds invest in commercial, corporate or rental properties, although they do occasionally dabble in residential investments. This type of fund can invest in properties directly, or indirectly through real estate investment trusts (REITs). Like stock funds, real estate funds can invest domestically, overseas or both.

Why Invest in Real Estate Funds?

Real estate funds allow small investors to participate in the profits from large-scale commercial real estate enterprises, such as corporate office parks and skyscrapers. They also provide the usual benefits of mutual funds, such as professional management and diversification. This last characteristic is key for these funds, as most investors do not have a sufficient asset base to participate in commercial real estate in any direct sense, unlike stocks, which may be purchased as individual shares at a much more reasonable cost.

Who Can Invest?

- Individuals;
- Accredited investors;
- Master funds;
- Private Family Offices.
- Private Equity and REIT (Real Estate Investment Trusts) Manager.

Real Estate Fund Investment Risks

Real estate funds face several kinds of risk that are inherent in this sector of the market. Liquidity risk, market risk and interest rate risk are just some of the factors that can influence the gain or loss that is passed on to the investor.

- Liquidity and market risk will tend to have a greater effect on funds that are more growth-oriented, as the sale of appreciated properties depends upon market demand.
- Conversely, interest rate risk impacts the amount of dividend income that is paid by income-oriented funds.

1- Closed-End Structure

Real estate funds are almost always closed- end funds. A closed-end fund is an investment fund intended to last for a fixed term, usually between five and ten years. Investors in a closed-end fund are generally not permitted to make withdrawals or additional capital contributions during the life of the fund.

Once funded, an investor's capital will be returned only upon the sale or refinancing of a fund asset, or upon positive cash flow from rents and other operations. Most real estate funds, private equity funds, venture capital funds, and other funds investing in illiquid assets are structured as closed-end funds.

2- Successive Funds

With closed-end, once an investment is sold, it cannot be reinvested in the fund. Rather, the fund sponsor would create a subsequent fund as assets are sold and investment proceeds returned to facilitate reinvestment. Successful private equity fund sponsors typically develop a portfolio of various funds. Fund sponsors can form subsequent, analogous real estate funds at substantial cost savings to the initial funds, because less legal structuring is required.

3- Domestic Real Estate Fund Structure

A domestic-only investment fund structure is typically comprised of the following entities:

- A limited partnership to act as the fund entity (although LLCs are becoming increasingly popular);

- An LLC to act as the investment manager of the fund, formed in the jurisdiction of the sponsor; and

- A general partner of the fund (managing member in the case of an LLC), also formed in the jurisdiction of the sponsor.

REAL ESTATE FUND STRATEIGIES

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REAL ESTATE FUND STRATEIGIES

Real estate fund strategies can be loosely categorized into one or more of the following groups:

1- Distressed Asset Funds

Distressed asset funds seek to identify undervalued assets that are over leveraged, suffer from cash flow issues, or are otherwise unable to access needed debt financing. Distressed asset funds tend to be cyclical, following general real estate market patterns.

2- Structured Finance Real Estate Funds

Structured finance funds, often referred to as leveraged buyout funds, seek to use substantial leverage to purchase real estate that has fairly stable value projections. Structured finance funds are also cyclical in nature, as they rely heavily on inexpensive access to debt financing.

3- Joint Venture Real Estate Funds

Joint venture real estate funds use a strategy of co-investment with other funds in a syndicated investment. Joint venture funds can sometimes subject the investment advisor to investment advisor registration requirements, as the co-investment relationship can be considered a security.

4- Real Estate Development Funds

Development funds are funds that acquire unimproved land or demolish existing property for re-development. These funds require substantial management involvement in working through the various municipalities permitting complexities as well as coordinating the various stages of real estate construction. Accordingly, development funds require substantial and complex offering document disclosures.

5- Multi-Strategy Funds

Multi-strategy funds are the exception to the specialization trend. Multi-strategy funds are not confined to a single investment strategy or objective (although they tend to be more asset-class specific). Multi-strategy real estate funds tend to have a low risk tolerance and maintain a high priority on capital preservation. Even though multi-strategy funds have the discretion to use a variety of strategies, we have found that fund sponsors tend to focus primarily on one or two core investment strategies.

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STRUCTURING PRIVATE REAL ESTATE FUNDS

Forming a private real estate fund provides a means for the successful real estate developer to access a dedicated pool of capital to fund new investment deals without having to raise capital on a deal-by-deal basis.

Private real estate funds enable managers to pool capital without having to navigate the cumbersome securities registration process involved in launching an REIT (Real Estate Investment Trust) or other publicly-offered investment fund. Despite the relative ease of implementation, private real estate funds are structurally complex and sophisticated investors will expect to participate on terms that not only align interests between the investor and general partner/ sponsor, but that also reflect current market trends.

One of the most important aspects of forming a real estate fund is setting the terms of the investment. When properly structured, real estate fund offering documents contain terms that adequately protect the fund sponsor and are attractive to investors. Real estate fund terms are driven by the fund's strategy, the market trends within the fund's specific asset class and the particular needs and objectives of the fund. It is crucial that the investment fund legal counsel have an in-depth understanding of current investment market trends and how those trends affect the strategy the fund will employ.

FUND EXPENSES

During the formation process the fund sponsor designates which of the expenses of the fund will be borne by the manager and which will be borne by the fund. Typically, the fund bears expenses directly related to forming and operating the fund, including: legal formation costs, accounting and administrative services, regulatory filings, brokerage costs, clearing costs, etc.

FEES AND EXPENSES AND RELATED CONFLICTS OF INTEREST

As an investment type, real estate is often susceptible to the imposition of many fees and costs, some of which can appear to be duplicative or improperly allocated to investors in a private real estate fund. Real estate funds generally charge investors a fixed management fee, based on a percentage of the fund's assets under management, to cover the manager's costs of operating the fund. General fund expenses are also typically factored into the overall net profit or net loss available to investors. For example, if a private real estate fund contracts with a third-party to serve as a property developer, general contractor, or property manager for the fund's investment assets, rather than utilizing the fund's general partner/ sponsor in such roles, investors may question the purpose or amount of the management fee.