Crittenden Pension Funds & Real Estate™

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## PFs WILL TARGET SPECIALTY FUNDS

Investment in smaller specialty real estate sectors will grow in 2008 as pension funds and their advisers look for properties that can provide good returns for low-leveraged acquisitions. Because the smaller niche specialty classes often depend on one-off deals and partners with expertise in management of the targeted properties, advisers have often been more attracted to assets that are simpler to manage, can attract long-term leases and require large investments. Expect PF investors to start looking harder for new real estate opportunities and selectively invest in special purpose properties for their investors as the real estate market cools off and good properties become available. On the multi-sector specialty fund front, **Harrison Street** leads what should become a trend. **Flint Creek**, which advises on specialty investments, will join Harrison Street in the ranks as a fund manager, launching its first real estate fund later this year. Demand from PFs for specialty investments should stay strong as PFs like the **Teachers' Retirement System of Illinois** continues to make allocations for separate accounts in specialty properties and **Kentucky Teachers' Retirement System** starts targeting timberland.

While these sectors tend to be less volatile and hold steady through economic downturns, historically, they haven't drawn the same attention as office, retail or multifamily. Hospitality is often considered specialty by advisers and investors, because success in that sector requires expertise like the other specialties, but unlike the smaller specialty classes, hospitality is more tied to economic ups and downs, as it's heavily connected with business and leisure travel. Additionally, hospitality has been more attractive to advisers because the investment size per acquisition tends to be substantial and there are many large hotel companies that can provide partnerships for management or even portfolio opportunities for single large-scale acquisitions. Meanwhile, if the U.S. economy sees a slowdown, student housing will remain solid with students going to college. The growing senior population will feed the senior housing market, and multifamily residents will fuel demand for self-storage space.

With few major competitors in the field and a strong handle on the specialty segment, Harrison Street leads advisers in offering a specialty fund that targets multiple sectors. It sees opportunity for development in education, senior housing/health care and storage, which are all highly fragmented segments that require one-off deals — a difficulty for other advisers that lack the know-how, relationships and willingness to make these smaller single-acquisition deals. Harrison Street, where co-founder **Chris Merrill** is managing director, looks to build portfolios of specialty assets that can eventually go to market as attractive packages for the institutional buyers that are unwilling to make the smaller deals. The adviser, which only targets off-market deals, is currently investing for its Real Estate Partners Fund I, which should be fully invested this year. The adviser has a strong pipeline of deals right now and expects to see transactions for 2008 ranging in sizes similar to what it saw in 2007, between $4M and $5M. Real Estate Partners Fund II will go to market sometime in 2008 and should expect to see PFs as investors.

Flint Creek plans a commingled real estate fund launch sometime in 2008. The adviser has been interested in starting its first fund to target smaller niche real estate classes, but the commingled fund has not been determined. Flint Creek has used its expertise and relationships in the niche real estate classes to set up partnerships between PF advisers and management/development companies and is well positioned to break into the fund management business. Flint Creek, where founder **John Nikolich** leads as managing director, will take a more conservative approach to targeting investments related to the growing senior population by avoiding assets with ties to government subsidies and focusing more on age-restricted housing. The group also works in the student housing and self-storage sectors and sees potential for specialty-focused investing in the workforce housing, medical office and lodging sectors. Flint Creek will likely set its first fund in the small range size and build upon its success.