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Real Estate Managers Jump on Creative Deal Exits Via Secondaries

As managers and limited partners seek liquidity in a tight market, they are turning to recap deals, continuation funds and joint ventures.

By Shayla Colon | October 19, 2022

Real estate managers are increasingly turning to creative tools in the market to sell assets from their funds as economic conditions toughen, tapping into recapitalization deals, joint ventures, continuation funds and secondaries deals.

The trend is spreading across the asset class, as it has in previous recessionary periods, said **Jeanne Roig-Irwin**, a real estate partner at **Clifford Chance.** Chatter around these transactions has picked up in recent months, with more of these strategies likely to occur as the economy progresses through a downcycle, she added.

The activity includes recap deals, in which managers sell a portion of the asset but retain some ownership, as well as entering into new joint ventures that similarly allow the general partner, or GP, to keep partial ownership and an inflow of promotion fees. And managers are turning to them because typical deal exit pricing is not attractive, Roig-Irwin said.

“We've been hearing from all our clients in the U.S. It sounds like this is kind of a global trend that not all sellers and [joint venture] transactions are adjusting their pricing enough,” she said.

Limited partners, or LPs, also are interested in staying invested in particular assets through these vehicles but want to do so at the right price, which is causing them to pause as they wait for bid-ask spreads to fall further into their favor, according to Roig-Irwin. And some joint venture deals now involve managers selling to a continuation fund to access liquidity, she added.

“It's something we're seeing I'd say a fair amount of, but more on a bespoke basis rather than it being pre-baked into the documents from day one,” she said.

Continuation funds had not been prolific in the space because real estate has had a “great ride up until now,” said **Peter Martenson**, global head of GP advisory secondaries and direct investments at **Eaton Partners**.

It is, however, now starting to stick as players on both ends seek out liquidity options, he added.

Blackstone Group, for example, has embarked on a $23.9 billion transaction to sell **Mileway** – a European logistics and industrial properties firm – into a newly formed continuation fund supported by three of the fund manager’s long-term core-plus strategies, as reported.

Continuation funds in private real estate can be structured like joint ventures, except for some nuances, and are often synonymous with recapitalization deals, said **Christine Patrinos,** a founding partner at **Mozaic Capital Advisors**, a secondaries specialist.

Managers are using continuation vehicles to provide LPs with accelerated liquidity on particular assets or the option or to stay invested if they see value extending beyond a fund’s lifespan.

Some participants often overlook the fact that a continuation fund is not a merger and acquisition, or M&A, event, Martenson said.

“When these are done correctly, the continuation vehicles are a win-win-win proposition for the old LPs, new LPs and for the manager who remains incumbent,” he noted.

CBRE Investment Management recently brought in about $599 million for a new fund and co-investment sidecar vehicle that is going after GP-led deals, which often support continuation funds, as reported.

Managers aren’t the only players interested in creative structures to exit assets from funds. Some LPs are pressuring managers to monetize certain assets that they don’t have high conviction on when there is a window to push through a sale.

David Elliott

“A lot of LPs are hamstrung right now. If they can access liquidity, LPs are all for it. I think the challenge is accessing liquidity. The markets [are] essentially on pause right now. And there's not much liquidity flowing through the market,” said **David Elliott**, managing director of **Pantheon’s** real estate team.

While traditional real estate secondaries was a muted environment the past few years, more LP deals are starting to come through under the radar at a slight discount, he said. It’s a trend that could become more pronounced in the coming months, he said.

In a secondary transaction, an LP will try to sell its stake in a particular private fund to other investors, especially to secondary funds. Mozaic Capital works with a range of institutional LPs to utilize the secondary market, often when they need to rebalance their portfolios.

Data from Mozaic Capital found secondary transaction volume increased in the first half of 2022 to $57 billion, compared to $48 billion in the first half of 2021.

Investors are likely to continue exiting real estate positions, with secondary volume picking up, Patrinos said.

“Secondary markets are providing a nice liquidity option for LPs and GPs alike,” she said.

Pricing has been the biggest challenge in the secondaries market, according to Elliott. The bid-ask spread is narrowing but not enough, although it may continue to contract to the point LPs want.

“I think it's going to be a very productive 12 to 18 months for real estate secondaries. I think it's a good spot to be in. It aligns with LP objectives of finding liquidity and aligns with GP objectives of continuing to retain assets,” he said.