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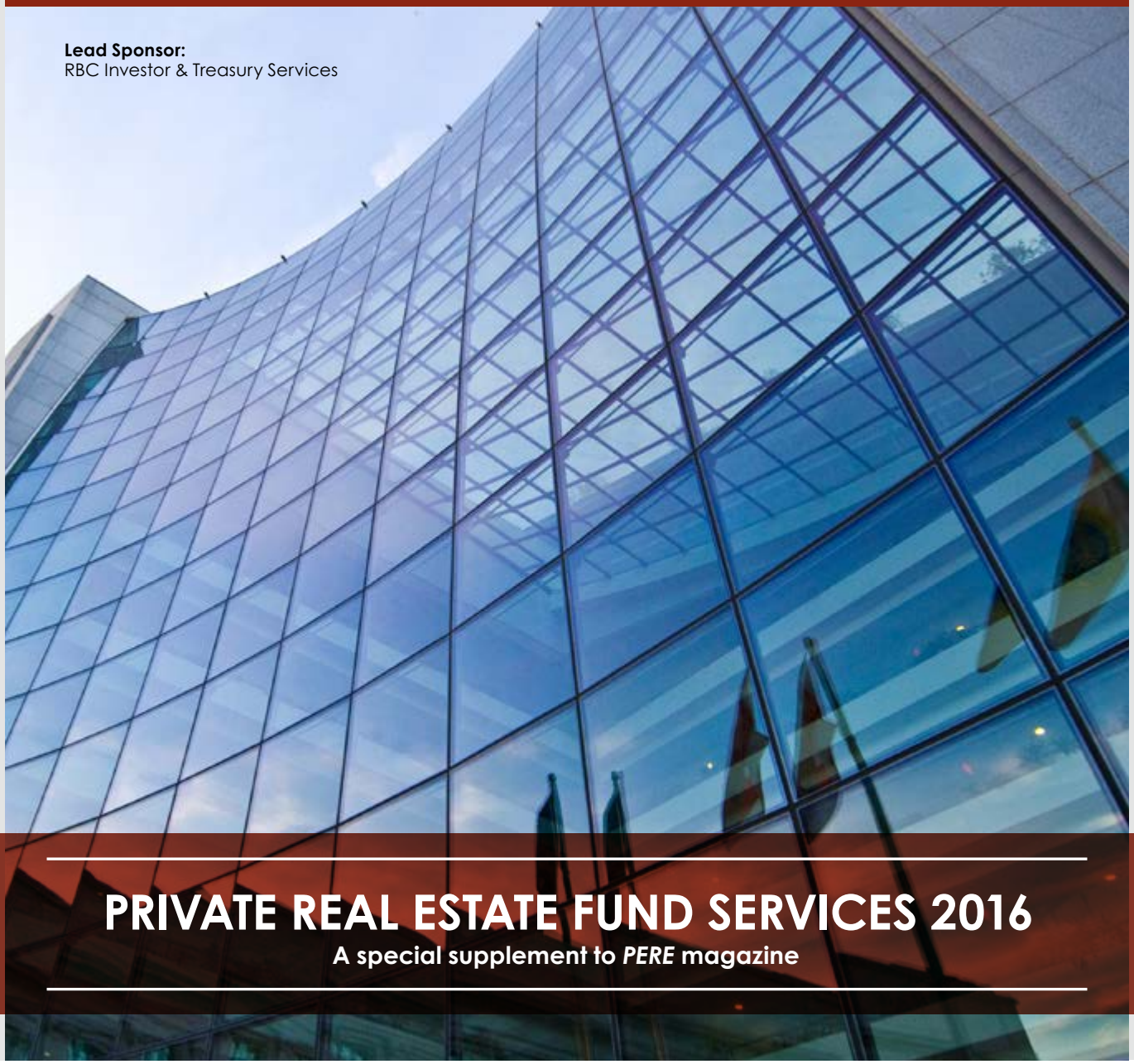

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PRIVATE REAL ESTATE FUND SERVICES 2016

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The transparency trend

Increased scrutiny from regulators has compelled private real estate to become more transparent. The benefits to the industry's image among institutional investors are resonating, says Dirk Holz of RBC Investor & Treasury Services (RBC I&TS). By Thomas Duffell

Over the past 18 months many institutional investors from across the globe have expressed desires to increase their private real estate holdings. The vast majority of these groups are increasing their exposure to property markets in a search for steady income as more traditional investment classes become either too volatile – like equities – or lack yield – like bonds. Yet since the global financial crisis these large pools of capital are only willing to invest in the most transparent financial markets. Dirk Holz, director of real estate and private equity at RBC Investor & Treasury Services, explains how increased regulation on alternative fund managers has been positive, with investors having a more favorable view on the industry and asset class.

PERE: Institutional investors across the globe are becoming more comfortable allocating capital to a more transparent private equity real estate industry. What is driving the transparency trend?

Dirk Holz (DH): The demands for transparency come from both regulators and investors. A few years ago it was typical for a real estate fund to have a yearly valuation and investor reporting, but now it is quarterly or sometimes even monthly. This is because the investor expectations are pushing fund managers to get closer to the standards that mainstream funds adopt around reporting, such as UCITS funds. In addition, regulators have implemented more data reporting requirements, but the main driver is still the investor. As the investor allocates more capital

they need regular information and communication from their fund managers, which in turn helps increase their level of comfort with the asset class.

This has been developing over time but you can clearly see now that the market has adapted to meet these requirements, resulting in institutional investors taking a view of real estate as a more mainstream investment. As they do, they are adding more people to their own real estate operations, and comparing mainstream asset classes to real estate with more confidence.

PERE: Fallout from global macroeconomic and political events tends to lead to a torrent of financial regulation. What should we expect after Brexit?

DH: The situation is quite different to the global financial crisis, which prompted a significant amount of additional regulation to further protect investors. However, groups that were looking at real estate in Europe typically saw London as a route in and aimed to set up their structures and operations in the UK. With Brexit they will need to reassess the situation as the UK and EU clarify the terms of withdrawal in the months and years ahead.

Take the AIFMD for instance; the key question that needs answering is whether the UK will be approved as a third country using the AIFMD passport, similar to Switzerland, Jersey and Guernsey. If not, then groups who were seeking access to the fund marketing passport through a London-based AIFM will need to look elsewhere or consider parallel fund structuring. Luxembourg and Ireland may well become more desirable while these unknowns still exist.

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Global groups that have already set up AIFMs in the UK will need to monitor the situation very closely or they could find themselves outside of the AIFMD in the years to come. Institutional investor expectations are for their fund managers to adopt AIFMD-compliant structures to meet the strong due diligence requirements of their investment policies. Whatever happens, the UK needs to ensure that its reputation as a significantly regulated jurisdiction continues post Brexit.

We are also seeing this trend for regulated products increase from US houses as they are no longer able to use passive marketing under AIFMD as a long term strategy. They are setting up European structures to gain local investors into their funds. In turn this is driving the market to greater streamlining of reporting and valuation methodologies.

Holz: the drive for greater transparency is having a positive knock-on effect for real estate

The AIFMD changed the game for fund managers looking to raise investment across Europe given the consistent compliance obligations now required across the EU. This, is turn, allows investors to select a fund manager without the need to weigh up the differences between local compliance obligations; they have the comfort that all EU jurisdictions maintain the same high standards and oversight.

Furthermore, the new implemented regulatory framework offers new opportunities and investor markets for fund managers. The latest regulations governing European Long Term Investment Funds (ELTIF) allow AIFMs to distribute AIFs to retail investors. This avoids the issues we have seen in the past in Germany, France and recently in the UK, where open-ended real estate funds for retail investors have faced a high number of redemption requests.

PERE: Have fund managers' back offices been able to keep pace with this greater demand for transparency?

DH: The biggest regulations to date have been implemented, such as AIFMD and FATCA. The speed of implementation has required fund managers to quickly organize themselves to document and monitor data points and other information in ways they had not done previously. It was quite a jump initially for these managers to move to a fully regulated product and engage a custodian and/or depositary, many for the first time.

Many have leveraged regulatory change as an

Regulation: leading to opportunities to improve operational efficiencies

opportunity to review and improve their operational processes. In some cases this led to the outsourcing of certain functions as the regulatory environment developed. In turn, this presented the opportunity for fund managers to focus on their core competencies while improving operational efficiency.

We have also witnessed changes among service providers as they too have become more specialized in ensuring they can deliver specific real estate services to meet their clients' needs. The jurisdictions they cover have decreased due to cost as well as the reputation of certain domiciles. It is no secret that the cost of implementing regulatory requirements can affect the appetite of providers; there are far fewer now offering services in 20-30 countries, for example.

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PERE: With the increased regulation, more data on underlying investors is required. Is there any other use for this extra data?

DH: There are a lot of service providers which are looking at using the data they hold to help inform both themselves and their clients. The information at hand potentially enables fund managers to better understand their efficiency, performance and costs, and obtain a more granular level of performance metrics. We are starting to see this with mainstream funds. Last year, RBC I&TS introduced Fund Sales Intelligence (FSI), leveraging our large market share of transfer agency activity across Luxembourg and Ireland. The insights we are able to derive from this big data helps our clients understand distribution trends by giving them in depth analysis of their own fund sales versus the market.

In the future there is likely to be similar uses of big data across the wider private real estate industry to uncover intelligence around performance, fund strategies, and investment thesis. For investors, it will be much easier to review where fund managers actively market their products, where they invest, and how they are performing. This makes the whole industry more transparent and more comparable, which may result in more institutional and traditional investment money being shifted into alternatives, and in particular real estate.

PERE: What role will FinTech play in increasing transparency within the real estate industry?

DH: We will see more statistics on risk and greater analytics being delivered from FinTech improvements. Investor expectations are for their managers to have best in class technology. They want to see up to date information delivered online and at different levels, from the most granular to high level checks. Tools where investors can have all the information and data points prepared to facilitate customization, download and extraction will become commonplace. Those that can meet these needs in a safe, secure and flexible environment will set the benchmark and have a much more competitive business.

I expect we will see a lot of collaboration between the traditional depositary and FinTech companies in the future; taking the best of what both can do to deliver a much improved, transparent and value added service. The pace and focus of FinTech companies is already leading banks and service providers to adopt a more agile process in developing new products and services for the real estate fund industry. ◻

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