Ahead of the regs

Dirk Holz of RBC Investor & Treasury Services talks to Theo Andrew about the latest trends in the real estate market, and how to get ahead of the game

Why are we seeing increased allocations to real estate?

In a continued low-interest rate environment, we are seeing a greater number of institutional investors with appetite to invest in real estate assets, either directly or indirectly through mezzanine financing and junior loans, with the potential to generate income-matching mid- to long-term liabilities.

Over the last few years we have seen healthy amounts of capital returned to investors in real estate funds.

Driven by this strong performance, we expect investors to continue to allocate capital to real estate. According to the 2017 March Preqin Key Trends, 45 percent of Europe-based fund managers planned to allocate significantly more capital to real estate investments in 2017 compared with 2016. We also expect to see more real estate fund launches by both first-time and experienced fund managers throughout the year.

Looking back to 2016, notable launches included the Blackstone Real Estate Partners Europe V, Starwood Capital Group, Carlyle Group, Oaktree Real Estate Opportunities Fund VII and PIMCO Bravo Fund III, which launched Europe-focused real estate funds.

How is the regulatory environment likely to affect the way in which real estate funds operate?

Against the backdrop of the UK's impending exit from the EU, we anticipate that real estate investment funds will find new ways to continue operating on the continent under the Alternative Investment Fund Managers Directive (AIFMD).

In light of earlier uncertainties surrounding whether the UK will retain access to the single market after Brexit, and what this will mean for the application of AIFMD, we have already seen large UK funds preparing to use Luxembourg and Ireland as a base in order to market and distribute their funds across the EU, and we believe this trend will continue.

The Channel Islands may also gain traction as fund domiciles following the finalisation of Brexit conditions. There is also greater appetite among US fund managers to set up real estate funds in Luxembourg or Dublin as a result of AIFMD.

Currently, these fund houses operate with Delaware, Caribbean and Grand Cayman structures, which are accessible to non-European investors.

By setting up parallel real estate funds in Europe, these same fund houses can attract and raise capital from Europe-based investors.

Debt capital seems to be an increasingly popular way for real estate owners to finance their deals. Is this something you are seeing?

The capital and liquidity constraints brought by regulations such as Basel III and Solvency II remain an impediment to increased lending from banks. As a result, real estate owners are increasingly looking for alternative sources of financing. At the same time, institutional investors are seeing the value that real estate debt can add to their investment portfolios, with a growing number looking to increase their allocations to this asset class over the coming years.

Interestingly, according to the 2017 Preqin Alternative Assets Monitor, 25 percent of real estate investors interviewed in June 2017 reported that the performance of their portfolios had exceeded their expectations over the past year.

How are the fund admin and asset servicing needs of investment managers investing in real estate evolving?

As investment managers continue to evolve and adapt to regulatory pressures and technology demands, we expect to see them further streamline their fund administration and custody operations.

For many, this will start with a review of the processes they want to keep in-house and those they want to outsource. Therefore, we anticipate that an increasing number of firms will look to the expertise of external custody and fund administration providers so that they can focus on their core competencies of managing investor relationships, portfolios and investments, and the marketing of launching new funds.

For those alternative investment managers who have been using external services for custody and fund administration, we expect to see these processes consolidated across just one or two specialist providers. For outsourced providers, this means increased competition and hence the ability to demonstrate offshore expertise. Investment in technology is also paramount for providing enhanced data analytics to investors for regulatory and commercial purposes.

Are there any other trends you are seeing in the real estate sector?

The application of new technologies to the administration and custody of real estate funds is a trend that we think will increase to help deliver operational efficiency and effective risk management. This would benefit areas such as accounting, which often involves manual processes. However, investment in new technologies such as artificial intelligence, machine learning and distributed ledger technology is still very nascent. **REIT**

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