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Insight

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Key trends **As a web of regulation, technology, big data and greater investor scrutiny piles the pressure on fund managers, outsourcing is gaining popularity**

Regulation, regulation… and tax

Private real estate fund management firms need to stay a step ahead of a tidal wave of jurisdiction, regional and global regulation and tax changes. The OECD's Base Erosion and Profit-Sharing and the EU's General Data Protection Regulation and AIFMD II are a drop in the ocean of the many keeping legal and compliance teams on their toes. As they can be challenging to navigate, some managers are turning to third-party fund administrators for support. "Managers may well have dealt with such things in-house in the past, but now are seeing value is asking the fund administrator to assist in these kinds of areas," says SANNE director Simon Vardon.

Technology and big data

The sector has been slow to embrace technology and utilize big data, but this is changing fast. In the last couple of years, managers have woken up to the fact both are now vital components to achieving operational efficiencies, reporting back to investors on fund and asset-level performance, maintaining good relationships with investors and staying competitive in this late-stage cycle.

But building and maintaining in-house IT systems is an expensive business, especially for smaller to mid-size firms. So it comes of little surprise that when a recent *PERE* survey asked managers where they were most likely to increase outsourcing levels in the coming year, technology came out top choice followed by data management.

And this is not a part of the fund management business likely to stand still. "The next decade of evolution will be even more profound than the prior 10 years," predicts Chandra Dhandapani, CBRE's chief digital and technology officer, so managers' need for external skills, expertise and support is likely to drive them further into the arms of third-party fund administrators.

40%

Managers planning to increase outsourcing of data management in the next 12 months

50%

Managers opting for Delaware as a fund domicile

Source: PERE Manager Survey 2019

Cybersecurity

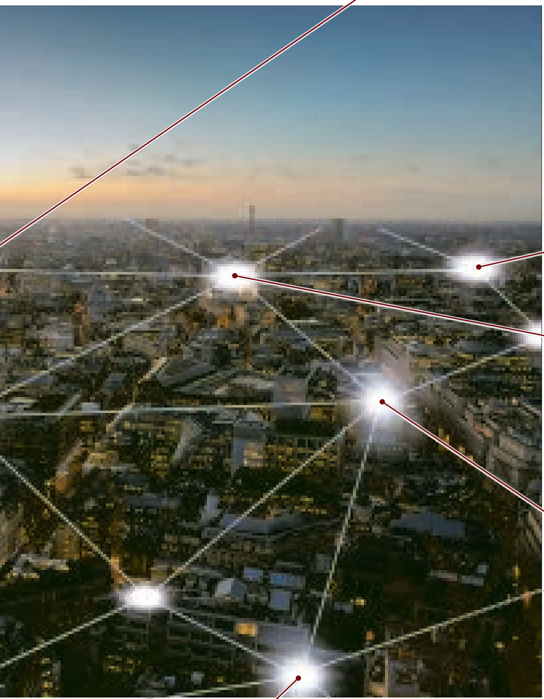
The darker side of the reliance on data and technology are concerns around data privacy and cyber-attacks. And it is an issue on the minds of C-level executives responsible for the operational and finance functions that keep the fund management firm ticking along. With more and more data now available, and critically in the cloud rather than on-premises storage facilities, investors are increasingly scrutinizing managers' security systems. LaSalle's UK and Europe COO Jamie Lyon highlights cybersecurity as increasingly a "point of inquiry from investors." And Chandra Dhandapani, CBRE's chief digital and technology officer, says "cybersecurity is always top of mind."

But with outsourcing of data management on the up, the onus is also on fund administrators to ensure the highest standards of security with both managers and investors keeping a watchful eye on the security credentials of service providers.

Investor pressure

As alluded to above, institutional investors in private real estate have become increasingly inquisitive and demanding of the fund managers to whom they allocate capital.

Investors are no longer simply interested in IRRs; they are beginning to dig far deeper into a much broader range of data points, such as managers' sustainability commitment and gender pay equality. This, in turn, is helping drive demand for the support of third-party administration services.



1 in 4

Managers that report no in-house expertise with big data

60%

Managers planning to increase outsourcing of technology in the next 12 months

Source: PERE Manager Survey 2019

Outsourcing

For all of the reasons cited here, outsourcing is on the rise across the alternative fund management business, including private real estate. Managers are taking advantage of the practice in an effort to optimize their operations, manage risks and business disruptions like tech and data proliferation and free up time to focus on their core business of raising funds and investing. For a deeper dive on the trend, turn to our special feature on p. 22.

Resourcing

With added pressures on managers, the staff behind the scenes keeping the firm functioning like a well-oiled machine are busier and more in demand than ever. Outsourcing services to third-party administrators might help ease their burden, but seeking the best staff in-house and holding on to talented C-level executives remains critical over the long term, particularly in an age when investors expect greater access to scrutinize that part of the business. Executive search firm Bohill Partners' founder Emily Bohill imparts her advice to CEOs on how best to do this: keep them challenged, recognize their contribution to the firm and make sure they are fully involved in "big conversations" with the front-facing investment teams.

Domiciling decisions

A key consideration when it comes to launching a new fund is which jurisdiction to opt for as a domicile. And in these times of flux and political and economic uncertainty, stability matters more than ever.

Joe Moynihan, CEO of Jersey Finance, highlights that it is "precisely because of Jersey's economic, regulatory and fiscal stability that managers and their investors continue more than ever to put their faith in Jersey…"

While managers are undoubtedly looking at new domicile locations for new funds, our *PERE* manager survey shows that Delaware remains the favored go-to with 50 percent of respondents, followed by Luxembourg and Cayman Islands.

Editor's letter

The growing appeal of outsourcing

Helen Lewer
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Keeping focus on any one activity for longer than five minutes can seem an insurmountable task nowadays. Take emails, for example – respond to two, along come 10 more needing urgent attention and attaching to-do lists requiring imminent completion. Such is the technology- and data-driven modern age in which we operate – instantly contactable, information and action needed now. Challenging for sure, often burdensome to manage, and also creating exciting new opportunities. But support is often essential if we are to navigate our way through the maze.

For private real estate fund management firms, technology and Big Data are certainly helping them achieve greater operational efficiencies across the business, to improve transparency and to collect the ever-more granular performance data, at both the fund and asset level, that investors are demanding. Indeed, it is facilitating closer and more trusting relationships with investors, allowing managers to answer due diligence questions faster and with more detail.

> **"Maintaining systems in-house, and finding the talent to manage them, can be costly"**

Nevertheless, it is an unavoidable fact that the race to keep up with technology and utilize multiple data points effectively, coupled with other external pressure points – regulation and tax, data privacy and cybersecurity, to cite just a few – can be a heavy burden for some managers to bear alone. Indeed, maintaining systems in-house, and finding the talent to manage them, can be costly, and eat into a managers' time and resources.

So perhaps it should be of little surprise that outsourcing activity in the sector is on an upward trajectory, albeit a slow, steady one – a NAREIM/FLP Associates global manager survey shows an increase of 8 percent between 2015 and 2019. And the sense throughout these pages is that the role of third-party administrators and service providers will continue to grow in the years ahead as managers seek to stay focused on attracting capital, investing and delivering returns to investors. That is, after all, the bread and butter of their business, and ultimately what they will be judged on.

Enjoy the report.

Helen Lewer

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KEYNOTE INTERVIEW

Navigating the new regulatory waters

Increasing regulatory complexity and globalization of real estate investments mean the role of fund administrators is growing in scope and importance, says SANNE's Simon Vardon

Since the global financial crisis (GFC), jurisdictions all over the world have been adding legislation intended to avoid a repeat. For real estate investment managers, this means an added burden on their back and middle office functions and a wider role for fund administrators. Simon Vardon, director, product development – real estate at SANNE, a UK-listed FTSE 250 fund administration company with 19 offices worldwide, talks to *PERE*'s Mark Cooper about the evolving role of the fund administrator.

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Q What was the traditional role of the fund administrator in real estate and how has it changed in recent years?

Traditionally, the role has always been a fairly basic back office one and the core tasks have been fund accounting and transfer agency services. It is fair to say that the landscape has evolved fairly significantly since the financial crisis, which precipitated a lot of change in the industry. Fund managers are now focusing much more on regulation and compliance for their structures alongside those traditional tasks for the fund administrator. More recently, a lot of the reporting requirements are being digitalized, a trend that we see increasing going forward. Fund managers are going to be depending more on their fund administrators for managing and processing more data than they have in the past.

15

Number of measures introduced by BEPS alone to eliminate tax avoidance strategies

Q What are the factors driving updated and increased regulation of real estate funds, and how can fund administrators help managers here?

We have seen a wave of new regulation, primarily aimed at investor protection and regulating parts of the industry which were previously unregulated. We now have the

Alternative Investment Fund Managers Directive (AIFMD), an EU regulation that sets standards for marketing and capital raising, remuneration policies, risk monitoring and reporting and overall accountability. In the US, Dodd-Frank introduced a wide range of reforms to the financial system.

The Organisation for Economic Co-operation and Development (OECD) framework on Base Erosion and Profits Shifting (BEPS) seeks to put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules. It introduced 15 measures to tackle tax avoidance and improve the coherence of international tax rules. Themes of transparency, fairness and accountability run through the various actions that BEPS introduced and fund administrators are needed to help navigate the new requirements and assist managers with compliance.

For example, BEPS Action Four is driving new rules around interest deductibility, introducing an EBITDA basis for interest deductions. Prior to this, for real estate – so long as lending terms were commercial and at arm's length – typically all interest payable on inter-group loans could be deducted. When this BEPS Action is enacted into local tax legislation, it may alter quite significantly the tax liabilities for various structures. As an administrator, we found that SANNE is well placed to help managers in running scenarios and modeling the impact of this.

Managers may well have dealt with such things in-house in the past, but now are seeing value in asking the fund administrator to assist in these kinds of areas, not least because an administrator is likely to have seen similar scenarios with different funds in the same jurisdiction.

Q How much variation is there in regulations around the world? What are the particular challenges for global managers and their fund administrators that run cross-border funds investing in multiple jurisdictions and tax regimes?

One question we are asked a lot is about our jurisdictional reach and expertise. Typically, managers want one fund administrator to service as much of the fund structure as possible. For real estate, that would include going down to the asset-level special purpose vehicles, which could be in a range of different jurisdictions, as well as the fund itself. Local expertise is key and managers typically want to understand how the fund administrator will deliver an effective and joined-up service while meeting local compliance needs.

Even though we have seen a lot of new

"Managers that provide a line of sight on their future focus and activity will typically see the most value added by their fund administrator"

Time to step up to tech

Technology such as AI and its implementation in real estate is also impacting the role of the fund administrator, says SANNE's Simon Vardon

"It really was not that long ago that we were still working with paper documents. There has been a fairly rapid change with a lot more digitalization of various processes and information. So, technology is a key area of focus for managers and they want to understand what fund administrators are doing in the technology space.

There are principally two main areas where there can be a real positive technology impact: efficiency and communication. Fund administrators are looking all the time at where automation can be used for elements of the fund administration process, because it can reduce errors, reduce response times and also reduce costs. There is typically an upfront investment required before the benefits of automation can be attained and it also requires underlying data to be complete, accurate and typically in a fairly standardized format for the benefits to be fully realized.

I think there is plenty of scope for automation to be part of improvements in various fund processes. Fund administrators taking the initiative are nurturing new types of expertise within their organizations, such as client service technology teams and technology and product specialists."

legislation and regulation that aims to harmonize standards, perhaps a little bit perversely there is also a lot of local variation in the implementation by different jurisdictions. This might include different deadlines, reporting formats and local guidance nuances. We find managers want to rely on the expertise of the fund administrator to help navigate those local variations.

The jurisdictional reach question is driving a lot of activity in our sector. Many fund administrators are looking to open offices in new jurisdictions to provide solutions in the jurisdictions where managers need them to be. Most fund administrators are looking to increase their international footprint. This is being driven by the demands of the managers that would like to have a fund administrator which can cover all bases, coupled with the increasing number of locations where investments are being targeted by managers.

Q It seems the direction of travel is toward more and more onerous legislation? Is the burden of regulation putting managers off funds?

It is probably sensible to assume that there will be increasing regulation going forward. However, I do not think increasing regulation is necessarily putting off real estate fund managers from seeking to launch funds – there is still a weight of capital from investors to deploy. However, the burden of regulation can be a barrier to entry for smaller or new fund managers. Managers targeting a relatively small fund still encounter a fairly fixed initial level of expense around diligence and compliance. Alongside collective investment schemes, what we do see in the real estate space is a good number of joint venture arrangements, which will be subject to far less regulation.

Q Issues relating to data and data security are also driving regulation. How is this developing and what do managers need to be aware of?

In general, we are seeing much more diligence and more questions being asked of fund administrators around data security and business continuity plans. The 'request for proposal' document is getting a lot longer. Managers are asking for more detail and a lot of that detail is around data and data security. In the EU, the General Data Protection Regulation (GDPR), which came into force in May 2018, is driving a lot of this. The potential penalties that GDPR introduced can be rather eye-watering, as they are based on a percentage of turnover. For example, British Airways is in line for a £183 million ($228 million; €204 million) fine, equivalent to 1.5 percent of its 2017 turnover, for a data breach.

GDPR and similar laws are a good example of legislation which, while not aimed specifically at the fund management industry, does have a direct impact. We have found that often the administrator can provide an effective line into the regulators to seek clarifications and confirmations on new regulation. That was definitely our experience with GDPR where we clarified the expectations of the regulators in relation to the fund space and for administered entities.

Q How is the relationship between fund administrators and managers evolving? What is the relationship dynamic?

There is an increasing trend toward working as a partnership. Managers that provide a line of sight on their future focus and activity will typically see the most value added by their fund administrator partner. It allows the fund administrator to be less reactive. Increasingly, structuring decisions or operational decisions are not completely concluded when a manager reaches out to a fund administrator, because they want to see if there is useful input from the fund administrator that can be brought to the table at that stage. Managers are looking for a longer-term partner. They are looking for a fund administrator that they would be comfortable using for subsequent funds and really get to know them well. We often find the dynamic extends to understanding the ownership profile of the fund administrator and considerations like whether the ownership profile complements long-term investment in technology and systems.

"New technology and regulations continually add to the tasks asked of fund administrators, but the core need for accurate, timely and secure reporting in a useful format remains"

Q To what extent are all the above factors forcing fund administrators to up their game and what will the role of the fund administrator look like in the future?

The fund administrator space is increasingly competitive, and while we see some firms seeking to secure mandates with aggressive pricing, I believe more managers want to have meaningful conversations with fund administrators about an important list of other topics. We see fund manager diligence and focus on the operational environment of the administrator being fairly continuous now and not just a one-time event at the time of appointment. New technology and new regulation continually add to the tasks asked of fund administrators, but the core need for accurate, timely and secure reporting in a useful format remains.

There is no single 'biggest challenge' for fund administrators; the biggest challenge is everything. A successful fund administrator cannot be strong in some areas and weak in others. There is little benefit in having offices in 25 locations around the world but not having a great infrastructure and a recognized fund administration system in place with good controls. Likewise, having a best-in-class compliance solution but only in one or two locations will not deliver the solution that many managers are seeking. Fund administrators must provide robust solutions that can meet the future needs of managers on all bases. ■

Simon Varden joined SANNE in 2013 and is director, product development – real estate.

View from the C-suite

Improving the transparency of data is vital, says James Strezewski, chief financial officer, Blue Vista Capital Management

Q How has the CFO role evolved?
The role has evolved into that of data manager. CFOs have always collected the data necessary to report to investors, but it is now incumbent on us to improve the transparency of that data regularly. Investors demand this as they improve their decision-making capabilities. In many cases, CFOs are charged with maintaining the accuracy and availability of data from all sources within the firm, including accounting information and fund operational and performance-related data. As a result, the CFO role is combining with that of a CTO; especially in small to mid-sized firms. CFOs have become the guardian of all things data.

Q What issue keeps you awake at night?
Unfortunately, tax issues. The ever-changing environment that federal and state tax legislation creates has me focused more than ever before on monitoring and adjusting those operational elements that we can effectively control the tax burden through. States are changing rapidly to react to the federal changes and there is little guidance available to validate one's decisions. Decisions made today may need to change as early as next year.

Q How important is technology to your role?
The CFO's involvement in technology development and implementation has increased significantly in the last decade. Technology is the fastest way to create efficiencies within our business, across nearly all our business units. We are constantly focused on where to create the next efficiency in our company. The difficult part for a smaller company is the 'how.' We have little redundancy in our employee base, therefore resources are scarce. We try to use a contractor model to bring in resources where needed and should the project become lucrative, we may hire that contractor as a full-time employee/vendor, similar to outsourcing.

Q What is the one question investors keep asking you?
How quickly the investment manager can produce financial information after the period closes. The second is whether we can meet their specific reporting needs, usually around consultant questionnaires, tax reporting, and other internal reporting requirements. Thankfully, industry organizations like the NCREIF/PREA Reporting Standards have helped to standardize these types of reports, which helps both investors and managers by defining results and allowing both parties to streamline data gathering and processing.

"CFOs have become the guardian of all things data"

Q What lessons have you learned in your role?
There is seemingly no end to the advancements in technology helping us accomplish our jobs on a daily basis. Our job has been to keep up with that technology, apply it in meaningful and useful ways and make the work environment the most efficient and productive it can be. Reliance on accurate data has increased alongside the increase in technology capabilities, but our ability to aggregate and validate that data is slow to follow. Too many organizations try to own and sell this data to the detriment of the advancement of our industry. In the interest of advancing our investment asset class, we need to address this issue in the coming years.

Q What is the single biggest challenge for CFOs in real estate in the coming years?
Retaining talented employees is always a challenge, but with the field of competitors for a relatively thin labor pool having increased in the past decade, it has become increasingly difficult. Creating a competitive salary and benefits package, and a desirable work environment while balancing the costs associated with providing these elements, is an annual challenge for the COO/CFO team and even more so for the small to mid-size companies. This challenge will remain unless the pool of investment managers shrinks or the labor pool increases in size; neither of which seems likely in the short term. ■

Top five sponsor issues in 2019

Guest comment by **Stephen Goler**

US fund management firms are facing increasing demands on their time and financial resources, writes Stephen Goler of Greenberg Traurig's real estate fund group

Here are key pressure points US managers currently face.

1 Attracting new investors

As savvy investors continue to enjoy a winning streak since the global financial crisis, there is little incentive for them to consider fund managers that are new to them. At the same time, institutional investors are looking to reduce the number of their investment sponsors with the goal of establishing deeper relationships with larger, more established sponsors and obtaining more favorable economic terms from them.

Barriers to securing new investors, particularly for smaller and mid-market managers, create increased pressure to outperform the competition as a means to attract new capital for future investment vehicles.

2 Downward pressure on promote and affiliate fees

The prolonged boom in this real estate cycle is driving down spreads and investment returns without any reactionary changes to waterfalls and hurdle rates. That, coupled with more heightened scrutiny of affiliate fees by existing and potential new investors, has resulted in a lower amount of absolute dollars finding their way to managers.

In response, certain managers have strayed from their core strategies in search of niche classes with the hope of generating higher returns for both investors and themselves, such as traditional multifamily players moving to student housing and/or tertiary geographic areas.

3 An ever-changing tax environment

Fund managers regard taxation as an unpredictable variable in their firm's financial futures. They must account for increasing real estate tax assessment valuations and rates, and the threat of greater taxation at the state level. The 2017 US Tax Cuts and Jobs Act is widely viewed as reducing the overall tax burden for real estate investments and real estate investors, but it created new challenges for managers, such as an industry-wide pivot toward greater utilization of real estate investment trusts in fund structures and an overwhelming interest in opportunity zones; both have resulted in increased complexity in fund structuring, investor education, and fund reporting and accounting.

Many managers implementing REITs for the first time in their 2018 and 2019 vintage funds and those pursuing opportunity zone investments are incurring significant education and compliance costs as they try to keep up with the pace of the market.

> *"Managers must account for increasing tax assessment valuations and the threat of greater taxation at state level"*

4 Stricter regulatory landscape and increasing compliance costs

Managers are seeing increasing demands on their personnel and financial resources in the form of new laws and regulations abroad, such as the EU's General Data Protection Regulation and the Cayman Islands' Anti-Money Laundering Regulations; and stricter enforcement of existing laws and regulations at home, such as Regulation S-P, the primary SEC rule regarding privacy notices and safeguard policies of investment advisors and broker-dealers.

Many managers are focused on privacy, security and AML best practices above and beyond what these laws and regulations require in an attempt to distinguish themselves from peers and to avoid the very public consequences of a breach or misstep. Although scaling investment platforms enables managers to dilute compliance costs across multiple funds, these costs ultimately reduce the overall return on equity for each investment.

5 Scarcity of quality investments

For all of the factors described above managers are increasingly finding themselves in situations where they must decide to pursue investments within their investment strategy at top-dollar pricing, pursue investments at the edge of – or outside – those strategies, or simply wait. The challenge is to remain disciplined and patient for the right potential investments to present themselves and to resist the desire to deploy capital for the sake of deploying capital. But there will eventually be a point where waiting too long results in getting left behind in the capital and real estate markets. ■

View from the C-suite

Blackstone's global head of compliance, Marshall Sprung, on striking the right balance between proactive and reactive

Q How has your role, and the compliance function, evolved?
I would point out two key dimensions: integration and technology. The business has greater appreciation of the extent to which compliance can be used to enhance our business objectives, which has led to increased compliance integration into business practices on every level, including product development, deal diligence and financial reporting. This ensures compliance is empowered and continues to have a seat at the table at the most opportune moments to partner with the business. And advancements in technology enable compliance professionals to be more proactive and efficient in ways that enhance their contribution to the firm.

Q What single activity or aspect of your role takes up the most bandwidth on a daily/weekly basis?
No two days are alike for me at Blackstone. Each day I balance the immediate issues that arise – information wall requests, conflict of interest assessments, data privacy questions, for example – with the longer-term strategic goals that I have set out for our global compliance program. In that area, I strive to ensure we have the appropriate talent, resources and structure to support both the firm's existing and new businesses or initiatives. Striking the right balance between reactive and proactive work is one of the most challenging aspects of the role.

Q What compliance/regulatory issues keep you awake at night?
A challenging aspect of my role is its global nature. We have business activity occurring in numerous jurisdictions around the world, each of which has a complex regulatory framework. So I need to manage the critical compliance work associated with this activity – everything from routine filings to distribution of our funds to regulatory inspections.

I am fortunate to have terrific teams in the US, Europe and Asia doing an outstanding job staying connected with the business in their region, their regulatory environment and firm leadership in the US.

Q How do you communicate regulation and compliance changes to the rest of the firm?
There is no one-size-fits-all approach. Some changes are relatively narrow in scope or impact only certain businesses, so communication by email or a targeted training suffices. Larger regulatory shifts require a broader and more co-ordinated effort, engaging all necessary stakeholders in both the business and support functions. One example is our implementation of the General Data Protection Regulation (GDPR), where we formed a steering committee consisting of key impacted functions – including HR, technology, legal and compliance and vendor management – and met weekly to drive the firm-wide change needed.

> *"We study compliance data to identify patterns that might indicate a greater need for training"*

Q How important is technology and data to your role?
Very important and becoming more so. As our firm grows in size and complexity, it is vital that our people have the technology they need. We formed a Legal and Compliance Technology Steering Committee to facilitate collaboration between our compliance and technology groups and determine our priorities in the technology area. That collaboration has delivered numerous improvements, including workflow tools, conflicts and personal trade clearance systems, enhanced email surveillance and even a bot that will assist employees with routine compliance questions. Data has grown more important as we study ways to analyze the compliance data that we collect to identify patterns that might indicate a greater need for training about our policies and procedures.

Q What is the single biggest challenge for CCOs in real estate in the year ahead?
We remain highly focused on longstanding regulatory priorities like fees and expenses, conflicts associated with affiliated service providers, allocation of investment opportunities, and valuation and marketing. But the most significant issue is ensuring that firms' use of affiliates and sponsor employees to provide fee-based services to properties is adequately disclosed. The SEC looks at many issues, but this one gives rise to the prospect for perceived self-dealing and often involves significant payments, a combination that makes this an issue that will continue to attract scrutiny. ■

EXPERT COMMENTARY

Alter Domus' Anita Lyse and Antonis Anastasiou discuss the merits of the third-party hosted AIFM platform, the solution many managers have adopted when establishing investment funds to be marketed to investors in the EU

Accessing European capital

The alternative fund landscape has changed dramatically in recent years, and especially so in Europe since the arrival of the European Union's Alternative Investment Fund Managers Directive, and it will continue to evolve through its next iteration with AIFMD Level II.

The AIFMD aims to regulate the entities involved in the management of alternative investment funds, and sets out the requirements that must be met by alternative investment fund managers when it comes to authorization, their general conduct of business, including mandatory transparency obligations, and the marketing of an AIF.

Anyone wanting to raise capital among the European investor community today have in essence two marketing options: the national private placement regimes, in certain jurisdictions where they are (NPPR) still allowed, and the AIFMD-compliant route, which requires the use of an authorized AIFM, which by definition is established within the European Economic Area.

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These options have been running in parallel since the adoption of AIFMD for non-EU AIFs raising capital in Europe. However, that is to come to an end by August 2021 as NPPR rules are gradually being abolished. Slowly but surely, this will make the AIFMD-compliant route the more sustainable and hassle-free option – indeed, the only option – available.

Raising European capital will therefore soon, unequivocally, require an EU-domiciled authorized AIFM, which the larger fund managers might have in their home country, although many prefer the use of an externalized service provider in the form of a third-party, or hosted, AIFM. This can be either as a long-term solution or as a transitional solution in case the manager has ambitions to set up an adequate infrastructure and obtain its own license. In today's market, the vast majority of third-party AIFMs are domiciled in Luxembourg.

The impact of Brexit

Due to the uncertainty and fear of a possible hard Brexit coupled with the pressure from investors in the funds managed by UK-domiciled AIFMs, larger managers have since sought to establish a Luxembourg-based AIFM to ensure continuity to the daily management of their vehicles as well as the ability to continue to market their funds throughout the EEA investor community.

Post-Brexit, however, the UK could be deemed as a 'third country', thus losing its passporting rights and therefore its ability to continue marketing to investors. Whereas temporary permissions are being discussed at this stage for live fund structures, managers that are launching new fund structures are seeking more long-term and sustainable solutions.

Being deemed as a 'third country' following Brexit, UK managers would fall within the same scope as US or Asian managers looking to raise capital from European investors.

Why managers are using a third-party AIFM

Establishing a fully-fledged authorized AIFM is an expensive, laborious and timely exercise, especially for smaller start-up managers or non-EEA managers without a significant presence within the EU.

This is further impacted by the release of the Circular 18/698 by the Luxembourg regulator, the Commission de Surveillance du Secteur Financier (CSSF), in August 2018. The Circular enhanced the governance framework of AIFMs, with stronger and clearer requirements for local presence, limitation of mandates, and internal control functions notably around oversight over delegated functions. It also included specific provisions to be implemented by management companies in regards to Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) rules.

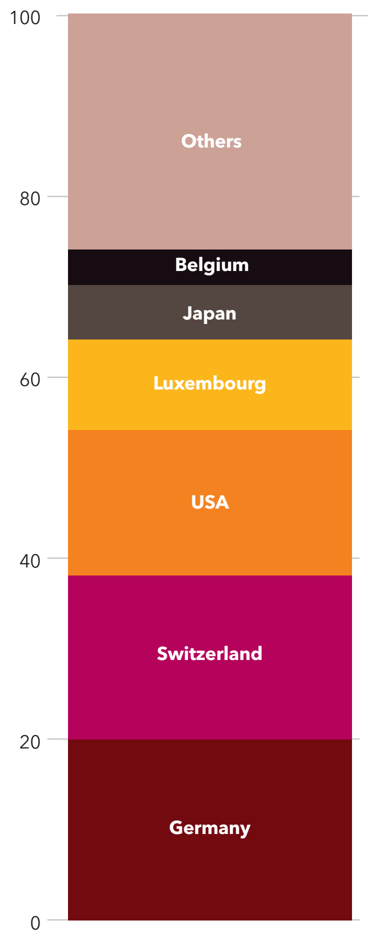
This has most certainly increased significantly both financially and operationally the barriers to entry for obtaining an authorization of a new AIFM license or the maintenance of an existing one. So managers that had established only a small local presence to face the minimal requirements to meet the regulations, but had the bulk of the operations being performed by central hubs throughout Europe or elsewhere, have suddenly had to staff up locally and maintain an infrastructure for additional operations in Luxembourg.

This has been the primary reason leading such managers to seek the help of third-party hosted platforms. Using such solutions provides a cost-effective contingency plan to maintaining continuity for firms without a dedicated authorized license. Managers can now leverage off the authorization of the regulated third-party AIFM and continue to focus on their core activities of raising capital and managing the portfolio of their funds.

In addition, firms, if they wish to, can minimize the scope of their local AIFM by fully or partially outsourcing the function to a dedicated third-party provider, which can provide the regulatory hub for the fund at a fraction of the cost of managing their own license and without having to worry about new regulations that could impact the AIFM in the future.

The Luxembourg AIFM market and environment

More than 40% of the top 50 licensed AIFMs come from non-EEA countries



Source: CSSF

Luxembourg, as one of the founding members of the EU, and one of the world's largest investment fund domiciles has positioned itself as the go-to domicile for private real estate fund managers to establish their own authorized AIFMs or to seek the services of third-party or hosted AIFMs.

The country's success in this area is the result of several factors: solid track record over several decades in both the UCITS world and the alternative investment fund space; political stability and ambition in the field; and a solid local network of specialized advisors and service providers.

As at the end of 2018, Luxembourg had 316 authorized management company entities – both UCITS and licensed AIFMs – employing just under 6,000 people and managing approximately €3.4 trillion. Although the bulk of this number comes from plain vanilla UCITS funds, looking at the new licenses granted in 2018 for management companies, 14 have been for new AIFMs with only two being for UCITS management companies, and three for super management companies (both AIFM and UCITS).

This is a clear indication of the trend that AIFs continue to follow the UCITS's footsteps in Luxembourg.

How to get comfortable with outsourcing the core business

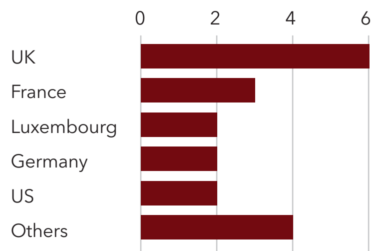
The two core functions of an AIFM are portfolio management and risk management, of which only one – not both – can be delegated out.

In Luxembourg, for example, the delegation of one of these functions can only be permitted if the delegate is an authorized and regulated asset manager in its country of domicile and a memorandum of understanding exists between the domicile country of the AIF and that of the asset manager.

New entrants flocked to Luxembourg in 2018

The uncertainty and fear over Brexit has driven several UK fund managers, in particular, to set up their own AIFM in Luxembourg to continue to take advantage of the EU passporting rules

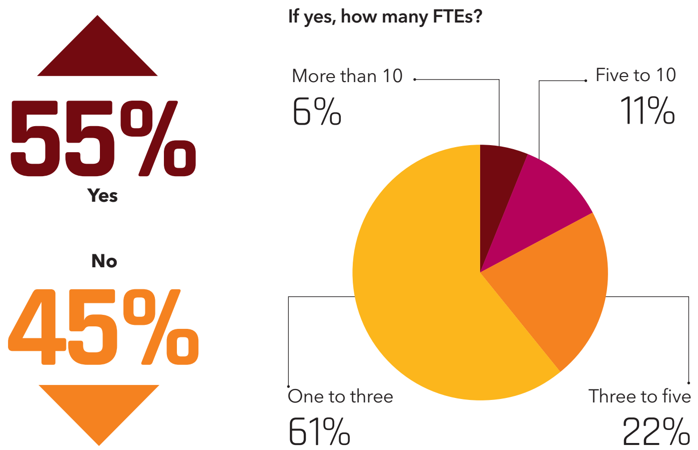
New AIFMs established in 2018, by origin



Source: CSSF

Does the implementation of Circular 18/698 require additional recruitment?

Over half of management companies and AIFMs have had to recruit more staff to manage their day-to-day operations with 22 percent of these having to recruit between three to five full-time employees.



Source: PwC's Observatory for Management Companies 2019 Barometer

In the case of Brexit, the general indication at this stage is that an MoU will be established between the Luxembourg and UK regulators and, therefore, an authorized UK AIFM could also potentially act as the delegated portfolio manager. This would give the UK AIFM full control of the daily management of the portfolio while the third-party AIFM maintains the risk management and regulatory requirements. This may be the most common set-up, although this is not yet supported by industry data and statistics.

On the other hand, for managers that are not regulated as an authorized AIFM or asset manager, the third-party AIFM maintains the role of the portfolio manager in-house, carrying the liability and control over the fund's investment portfolio. This can give rise to concern for managers; they could understandably view this as an additional layer of control, and with potentially costs and delays in the investment process, which ultimately gives a feeling of loss of control of their fund operations.

Mitigating this concern can, however, be overcome with the implementation of solid procedures designed at the on-boarding phase. This provides managers with an understanding of the requirements and duties of the third-party AIFM, but also the guidebook and processes to be followed to ensure a timely review and approval for the recommendations provided by the manager. This should give the asset manager the relevant comfort of an established and smooth operating framework and communication flow between themselves and the external AIFM.

Another key AIFM function is valuation. While this can be delegated to an external accredited appraiser under AIFMD, it is in practice very rarely done because of the liability that would go with it, among other reasons. As a consequence, third-party AIFMs usually maintain this function internally and need to demonstrate a robust and independent internal valuation framework.

In the real estate world, however, as opposed to private equity or, even more so, in venture capital where valuation is often done by the asset managers themselves and sometimes only on an ad-hoc basis, it is the norm to have an external appraiser appointed at least annually due to the multitude of reputable, local and specialist valuers. Such appraisers would provide the AIFM with a valuation which is then used as the basis of their internal review.

Over and above the regulatory, cost-effective and efficient solution a hosted AIFM can provide, the third-party AIFM's experience and expertise in real estate as an asset class is of key importance for real estate managers in the selection process. Third-party AIFMs will need to obtain specific licenses to manage funds investing in different asset classes. Managing plain vanilla UCITS funds or venture capital funds is obviously very different from investing in different types of real estate assets and strategies. Ensuring the hosted AIFM has the ability and, most importantly, the relevant skill set – with in-house dedicated personnel who are able to seamlessly integrate with the managers' operating framework and comprehend the intricacies and specificities of the asset class – can avoid potential frustrations, and ensure a smooth, efficient and long-standing relationship. ■

Anita Lyse is global head of real estate at Alter Domus
Antonis Anastasiou is a managing director of the Alter Domus management company

View from the C-suite

The pace of change for the chief operating officer shows no signs of slowing, says Jamie Lyon, COO of LaSalle Investment Management's UK and European operations

Q How has the COO role in the real estate fund management firm evolved?

The definition of the roles and responsibilities of a chief operating officer can differ greatly from firm to firm and even within a firm. In my experience, the role continues to expand and deepen to include a wider remit with greater responsibility.

New activities are taking greater prominence and can dominate, even in the short and mid-term. In the here and now, big data, data governance, risk management and an increasing fiscal and regulatory complexity dominate. 'Operations,' no matter the definition, are an increasing internal focus but equally an increasing external focus as evidenced by existing and new investors' questions, due diligence and audit.

COOs should be able to look across all the horizontals within the business and have a balanced and 'unbiased' opinion across all business lines and disciplines. The cross-business knowledge can be invaluable.

Q In your role, what issue keeps you awake at night?

There is a sector impatience to have technology solutions today, but the real estate industry as a whole is playing catch-up in this particular area. If the perfect solution were out there, we would all be knocking down the door of the software or technology providers, but the silver bullet does not yet exist. This means there can be an inefficiency and a frustration.

Q How important is technology and data to your role now?

It is absolutely important but we should emphasize that it is critical to everyone's role, not just to the COOs. The challenge is to make it high on everyone's agenda. Technology and data can no longer be viewed as a back-office responsibility, but as the responsibility of everyone. The good news is that the subject is certainly making its way up the agenda for our industry and getting more senior leadership attention and focus. I talk to peers and fellow COOs, we share experiences across companies and across regions, we share frustrations and successes and we try to educate and encourage the technology providers on what we need. It isn't easy, though!

There are huge benefits in efficiency and having confidence in the completeness and accuracy of data for quick and effective decision-making and reporting to clients. The biggest challenge, however, can be to find the time over and above everyone's day job. 'Big Data' needs focus and time to drive forward. This can, in itself, lend weight to the argument to finding the correct outsourced partners and exploring solutions that leverage third-party platforms and their investment in technology.

> *"Cybersecurity is a common point of inquiry from investors, and one we have spent a lot of time planning around our business"*

Q Are investors asking to see you personally now during due diligence? What is the one question they keep asking you?

The subject of 'operations' is high on the agenda of any investor or consultant due diligence process. While they might want to see and hear from the COO, they want to meet the direct team even more so. This illustrates their want to understand the detail and explore that detail with those who are doing the 'day to day,' and I would encourage this. In my experience, questions around controls and risk management are the most frequently asked, and cybersecurity is an increasing point of inquiry from investors, and one we have spent a lot of time planning and implementing around our business.

Q What lesson have you learned in your role?

Never to be complacent, always over communicate and share. Try to lead by example with an enthusiastic 'can-do' and 'glass-full' mentality. Always be inquisitive.

Q Looking forward, what do you see as the single biggest challenge to COOs in real estate?

There is an increasing pace of change, and the need to be innovative, agile and nimble prevails. Learning agility is a must, with a curiosity for change and to embrace the brave new world. ■

Tax law is at a crossroads

Guest comment by **Matt Probert**

Savills Investment Management's head of tax on the new rules that will impact how European real estate managers structure investments

Despite the regular stream of tax law changes from governments in the 20 years of my tax career, it is fair to say that, as far as European real estate investors are concerned, not many changes have been fundamental. Today's structure diagram for a pan-European fund looks very similar to one from 20 years ago. It will show a fund vehicle, maybe with a couple of feeder funds, a holding platform in Luxembourg or the Netherlands, probably as many property-owning special purpose vehicles as there are assets, and multiple shareholder loans. However, we are now at a crossroads and things are beginning to change fundamentally.

To understand what is happening, let us first take a trip back in time. At the time of the global financial crisis, the foundations of the international tax system had not changed since the 1960s. However, during this period the world had become increasingly globalized and businesses were using this time to, depending on your point of view, plan their tax affairs more effectively or exploit the numerous loopholes.

Following the global financial crisis, this became an issue in the mainstream press, with multinationals such as Starbucks, Google, Amazon and Apple facing a trial by media with respect to their perceived legal abuses of the tax system in which, it was alleged, they shifted profits around the globe to escape tax. Something had to change, and the response was the Base Erosion and Profit Shifting initiative.

The OECD launched BEPS in 2013. Its objective was to prevent the shifting or erosion of taxable profits by a co-ordinated framework adopted by OECD and G20 members. It revolves around 15 key actions in areas such as transfer pricing, treaty abuse and interest deductions.

"Legislation is simply becoming more complicated. Having the right tax advice remains of vital importance to any investment manager but it is also important to stress the importance of having high-quality internal tax teams"

Why BEPS is relevant to investors now

We have reached the point where the OECD's work is beginning to translate into new tax rules across Europe. Those rules have either come into effect already or are about to, and they will make a big difference to how European real estate managers structure investments. Here are three examples of how this is happening.

Interest deductions

It has been over a decade since Germany introduced a rule to limit tax relief for interest costs to 30 percent of EBITDA, which would only apply if annual net interest costs exceeded €1 million, which was later raised to €3 million. This rule was novel because it limits tax relief for interest on bank debt as well as related party debt, though the high hurdle and lack of grouping rules has limited its practical impact on larger deals. However, most other jurisdictions have now introduced similar rules, or are about to, often with a much lower threshold. For example, the threshold in Poland is three million Polish zloty ($790,000; €704,000), which catches all but the smallest deals.

Hybrids

For real estate investors, this is probably the most complex area of BEPS. Hybrids are instruments that are treated as debt in one jurisdiction and equity in another. In this way, a borrower may be able to obtain tax relief for interest paid to its parent, but the parent is not taxed on the income, because in its own jurisdiction it is treated as receiving tax-exempt dividends. Anti-hybrid rules stop this type of arrangement by denying tax relief on interest paid on a hybrid. However, it is – unfortunately – a little more complicated than that.

For example, a property-owning SPV may discover it cannot claim tax relief for interest on a shareholder loan because an investor in the fund partnership three tiers above views the partnership as tax opaque rather than tax transparent. Many readers will be familiar with requests from US taxable investors for entities to make 'check-the-box' elections to treat the whole fund structure as 'flow-through' entities for US tax purposes. These elections have the effect of making intra-group loans 'disappear' for US investors, thereby creating a hybrid.

The result is that a request by a single US investor to address a particular US tax issue increases tax leakage for all investors. However, the rules are being implemented differently across Europe, so we can expect very different answers depending on the location of the investment.

Tax treaty abuse and withholding tax

It has been common to use holding platforms in jurisdictions such as Luxembourg or the Netherlands for many years, and the need for 'substance' – that is, a physical presence – is a well-trodden path. However, BEPS will introduce a 'principal purpose' test. In summary, this will deny tax treaty benefits where it is 'reasonable to assume'that the obtaining of tax treaty benefits was one of the 'principal purposes' of an arrangement. Where a manager does not have genuine functions being carried out in the holding jurisdiction, this is quite a low bar for the tax authorities to clear, and its effect would be to increase withholding tax costs on the repatriation of dividends and interest.

What this means for managers

First, private real estate managers need to appreciate that the world has changed. A structure that 'worked' five years ago may no longer be appropriate. Therefore, it is important to ensure proper engagement between investment and tax teams at an early stage in order to avoid surprises later.

Second, if holding companies in places such as Luxembourg or the Netherlands are to be used, then there must be a good reason for using them and that reason should relate to genuine economic activities. This goes some way beyond the appointment of professional directors provided by a fund administrator and requires a holistic approach to business resourcing.

Third, there is a growing overlap between regulation and tax. For example, holding investments in French SPICCAVs *(Sociétè de Placement À Prépondérance Immobilière À Capital Variable)* and Italian real estate investment funds convey tax benefits compared with unregulated companies or partnerships. But establishing and running such vehicles requires a different skill set, particularly in complying with ever-increasing regulation, not to mention regulatory approvals.

Finally, legislation is simply becoming more complicated. Having the right tax advice remains of vital importance to any investment manager, but it is also key to have high-quality internal tax teams. As the connections between different issues become more complex, it becomes more important for the tax function to work alongside investment professionals to structure deals and deliver to clients. ■

EXPERT COMMENTARY

Jersey is uniquely equipped to help managers adapt to new trends and investor behavior, says Joe Moynihan, CEO of Jersey Finance

Stable, certain and innovative platforms are what managers want

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The asset management landscape has changed considerably in the decade since the global financial crisis (GFC). The effects of quantitative easing and a persistently low interest rate environment, as well as, in recent years, growth in high-net-worth populations in emerging markets and recognition in developed economies of an urgent need to respond to pension gaps, have all led to a rise in allocations to alternative asset classes.

This has translated positively for Jersey, where the value of fund assets serviced rose 10 percent in 2018 to reach a new record high of £320 billion ($397 billion; €357 billion), with alternatives representing 86 percent of total funds business in the jurisdiction. And while the expectation is that alternatives will continue to rise in popularity, it will not be without challenges.

As far as real estate is concerned, the indications are that appetite to allocate to the asset class remains substantial, but investors are modifying their behavior and are generally looking to put less money toward fewer funds than a year ago. In the long term, the indications are positive, with 36 percent of investors planning to increase their allocation to real estate, according to Preqin Investor Outlook H1 2019. In the shorter term, however, while 52 percent of investors are planning to make a single new commitment to the asset class over the next year, they also expect to commit less capital, suggesting a more cautious approach, as highlighted in Preqin, Quarterly Update, Real Estate, Q2 2019.

For fund managers, the year ahead looks set to be challenging in terms of fundraising – while a large number of new private real estate funds have been brought to market in the first half of 2019, almost one in five funds have been in market for more than two years.

From a jurisdictional point of view, understanding these subtle trends is vital. As managers respond to investor behaviors, fund centers will need to provide a stable platform that affords managers the flexibility they need in the short to medium term and that are forward-thinking enough to help maintain investor confidence in the longer term.

Jersey's ability to offer a certain, global solution for servicing private real estate funds puts it in a strong position to support those needs.

Stability and simplicity appeal to managers

It is no coincidence that Jersey's appeal has been heightened in the face of global uncertainty. It is precisely because of Jersey's

New York launch: Jersey Finance's new office is in response to more US managers looking to establish funds in centers like Jersey

economic, regulatory and fiscal stability that managers and their investors continue more than ever to put their faith in Jersey – the value of real estate funds serviced in Jersey has grown by more than 70 percent over the past five years, according to figures from the Jersey Financial Services Commission (JFSC).

While interest rates and asset valuations remain big challenges in the eyes of investors, it is telling that for one in five investors, the geopolitical landscape remains a key concern too, according to the Preqin Investor Outlook H1 2019 report. Nowhere else is this more evident than in the context of Europe, as the UK continues to look for a political solution to its withdrawal from the EU.

Jersey has read the political climate prudently to the extent that stability has become one of its key strengths. As far as Brexit is concerned, being outside the UK and the EU but with strong ties to both, Jersey is able to bridge the gap between the UK and EU, regardless of the outcome of Brexit. As a result, the number of managers choosing Jersey to structure their EU-focused funds through targeted, cost-effective private placement grew by 13 percent last year, according to the JFSC. These are strong figures that sustain a growth trajectory Jersey has been seeing for some time.

A stable and straightforward fiscal base is vital too and managers have consistently found that Jersey's tax-neutral model works very well for capital pooling. Jersey companies are taxed at zero percent while limited partnerships are tax-transparent, which is simple for managers and investors to understand. This compares well to other jurisdictions, where there is often a need for complex hybrid instruments or double taxation rulings to achieve similar results. Ultimately, it is simplicity that will resonate with managers.

Certainty in globally challenging times

Political and market uncertainty is, of course, not just restricted to Europe, and Jersey has seen increasingly that managers from markets further afield, including the US and Asia, are looking to futureproof their funds through a jurisdiction that can offer them long-term guarantees.

Managers must be ready to adapt to these subtle trends and being able to rely

Vital statistics

Jersey remains a compelling domicile choice for private real estate fund managers

The total value of funds serviced in Jersey stood at £320 billion ($397 billion; €357 billion) at the end of 2018 – the highest value ever – with real estate fund values growing 10 percent in the last 12 months.

1. There are more than 100 funds in Jersey focusing on UK real estate, according to Monterey.
2. In 2018, around 35 percent, by net asset value, of the constituent funds quoted on the AREF/IPD UK Quarterly Property Fund Index, made use of a Jersey structure.
3. Jersey is home to more than £600 billion in corporate asset vehicles and around 80 percent of that is invested in real estate with a strong emphasis on UK commercial real estate (Capital Economics).

on a jurisdiction that can blend certainty of global market access with flexibility will be pivotal in enabling them to do so.

With real estate investors targeting predominantly developed markets in the months ahead, Western Europe is set to remain the most targeted region. However, according to the latest real estate quarterly update from Preqin, a substantial proportion of investors are seemingly shifting their geographic preferences toward North America.

This is one reason why Jersey Finance is launching a new office in New York this year – a move based on the conviction that Jersey can act as a high-quality, pan-Atlantic servicing location, offering a compelling proposition as a gateway into Europe for US managers. In fact, US promoters' assets under administration in Jersey have increased by 148 percent over the past five years, according to Monterey.

While there is strong interest in the European market among US managers, there is not always a clear understanding of the EU's Alternative Investment Fund Managers Directive (AIFMD) regulation, how the market works or the most cost-effective way to access it. With that in mind, Jersey's message to US managers is that its private placement solution can provide them with quick, straightforward and cost-effective access to EU and UK capital and assets.

And because Jersey is outside of the EU, it offers an attractive level of flexibility if managers are also interested in targeting investor markets beyond Europe. Doing so from an onshore European location would be more costly and burdensome.

Pragmatic response to UK tax change

Legislative changes relating to the application of capital gains tax (CGT) on the disposal of UK commercial property by non-UK investors came into play in April.

The legislation introduces new rules, designed to prevent the potential for multiple layers of taxation within a structure, that apply to collective investment vehicles investing in UK real estate – a 'transparency election' and an 'exemption election'. Jersey offers a range of regulated structures all able to utilize these elections.

Joe Moynihan, CEO of Jersey Finance, comments: "The UK government has been pragmatic in finding a positive way forward on this issue. Overall, this response should give confidence to overseas investors and sends a clear message that the UK commercial real estate sector is an attractive future prospect and that Jersey remains a clear choice for channeling institutional-grade investment into the sector. In fact, the expertise Jersey can offer will be absolutely vital in supporting managers with the new rules and advising them around the options now open to them."

An innovative environment

Maintaining an ecosystem that is alive to the behavior of investors and the needs of managers against a backdrop of geopolitical uncertainty is absolutely vital, and Jersey is committed to achieving that by focusing on regulatory and digital innovation.

It is the case that robust standards of regulation are increasingly important to both manager and investor decision-making, and this has become a significant advantage for Jersey, which has in recent years scored extremely high on standards of regulation, featuring as a top-tier jurisdiction when assessed by global authorities such as the Organisation for Economic Co-operation and Development (OECD), International Monetary Fund (IMF) and the EU.

"Maintaining an ecosystem that is alive to the behavior of investors and the needs of managers against a backdrop of geopolitical uncertainty is absolutely vital, and Jersey is committed to achieving that by focusing on regulatory and digital innovation"

JOE MOYNIHAN
Jersey Finance

The introduction in January of economic substance legislation is a case in point – legislation that reflects Jersey's ongoing commitment to nurturing a substance-driven environment for fund managers.

Meanwhile, Jersey's focus on creating a digitally-led environment – the island has the world's first full fibre telecom network delivering speeds of 1Gbps and is currently third in the world broadband speed ranking, behind only Taiwan and Singapore – means it is able to provide the sort of reliable, quick and always-on platform managers need. This advanced framework is positioning Jersey strongly as a fintech center on the international stage.

Indeed, Jersey has a good track record when it comes to digital: it was home to the world's first-ever regulated bitcoin fund; last year global crypto exchange Binance established an operation in Jersey; and applications for the Jersey Private Fund – rapidly becoming the go-to vehicle for institutional investors – went 'online only' in 2018.

Maintaining this sort of forward-thinking environment is vital. The long-term future for private real estate funds looks bright, but with market uncertainty and geopolitical instability threatening to disrupt the sector, those International Finance Centers (IFCs) that can provide managers with a stable, innovative and certain fund servicing platform have an opportunity to play a critical role. ■

Joe Moynihan is CEO of Jersey Finance

View from the C-suite

No one can be complacent when it comes to protecting data, says Chandra Dhandapani, chief digital and technology officer at CBRE

Q What prompted your appointment and how has your role evolved since you joined?

CBRE is keenly in tune with the current and emerging needs of clients and professionals in the real estate investment world, so the CEO and the board decided to sharpen the firm's focus on digital strategy and technology enablement, and this prompted the creation of my role as chief digital and technology officer in 2016. In addition to digital strategy and all aspects of technology, data strategy and capabilities have become a more significant part of my role since I joined and I also now have executive oversight over the valuations and advisory services business, which includes property appraisals.

Q What single activity or aspect of your role takes up the most bandwidth on a daily/weekly basis?

Typically, I spend time on strategic issues with my team as well as the CBRE executive committee, client engagements and engaging with our professionals globally to understand their specific needs and challenges first-hand, as well as promoting the role of data and technology in real estate. As we speak, I am currently on a multi-week tour of EMEA and Asia-Pacific visiting our clients and teams in multiple countries.

Q How do you collaborate with the rest of the operations team on technology and data-related issues (for example tech upgrades, cybersecurity and transparency)?

I work with a talented CTO who manages day-to-day technology operations globally as well as cybersecurity issues, which is a top priority for us. He and I stay connected on a regular basis. We also have formal reviews and comprehensive dashboards, which give us ongoing visibility into the health of the firm's operations.

Q In your role, what issue keeps you awake at night?

Cybersecurity is always top of mind. No one in this industry can afford to be complacent with regard to the protection of data and technology. Beyond that, as the incumbent leader in a rapidly evolving industry, CBRE has so many opportunities ahead of us, so I think a lot about strategic opportunities that would extend our lead over the next three to five years and beyond.

Q Where do you think the biggest tech spend will be in the next two to three years?

Overall, as companies learn to recognize value from tech spend, they will continue to invest more. This will range from modernizing current infrastructure to be more cloud-based and creating new capabilities, such as platforms to improve employee experience in the workplace to meet the emerging needs of clients. I believe data and data-related capabilities, like AI and machine learning, will also see more significant spend in the next two to three years because the commercial real estate industry is starting to see the value of data as an enabler and we are starting to see more data being collected.

Q What is the single biggest challenge for CDOs/CTOs in real estate in the coming years?

There has been a lot of buzz related to proptech, with billions of dollars of venture capital investments flowing into the industry. With this trend, the biggest challenge for CTOs will be to balance financial discipline with forward-thinking innovation, and to focus on a clear set of priorities that reflect the company's growth strategy while avoiding distraction.

Q What lessons have you learned in your role?

Having a clear strategy and vision and communicating that strategy in very simple terms is incredibly important to get everyone in a large, global, multicultural organization to row in the same direction.

Q Looking forward, how do you see technology affecting the industry?

This is a great time to be in technology in real estate. The next decade of evolution will be even more profound than the prior 10 years. Managing, leveraging and differentiating data is a hard challenge and not something all companies can master, but at CBRE we are committed to lead in this space and I look forward to the road ahead. ■

Outsourcing to maintain core strength

More and more managers are using third parties for fund administration and other functions. NAREIM CEO Zoe Hughes interviews FPL Associates senior director Erin Green on how the trend is helping firms focus on the main business

The world of the real estate investment manager is becoming increasingly complex. Investors demand more reporting and transparency and the sector can no longer ignore the impact of technology.

Fund administration – the range of activities carried out in support of running a collective investment scheme – is important, but rarely a core competency of real estate managers. More are looking to outsource this function and other back and middle office responsibilities to third-party specialists.

For the past 11 years, the National Association of Real Estate Investment Managers (NAREIM), a US industry body, has partnered with professional services company FPL Associates on a global management survey. Here, NAREIM chief executive Zoe Hughes talks with FPL senior director Erin Green about the outsourcing portion of the survey.

Erin Green: If we take a look at the 2019 survey results, what we see is that, on an unweighted basis, about 28 percent of firms reported that they are outsourcing fund administration services today. Another 12 percent are doing it in-house today, but they are actively considering outsourcing, and the remaining 60 percent – the majority of firms – are doing it in-house and are not actively considering outsourcing. If you look back to the first year we asked that same question, in 2015, only 20 percent of firms were actively outsourcing. So that number has gone up from 20 percent to 28 percent. It is not something that happens overnight, but there is a trend of firms moving toward the outsourced model for fund administration and it is a trend we expect to continue going forward.

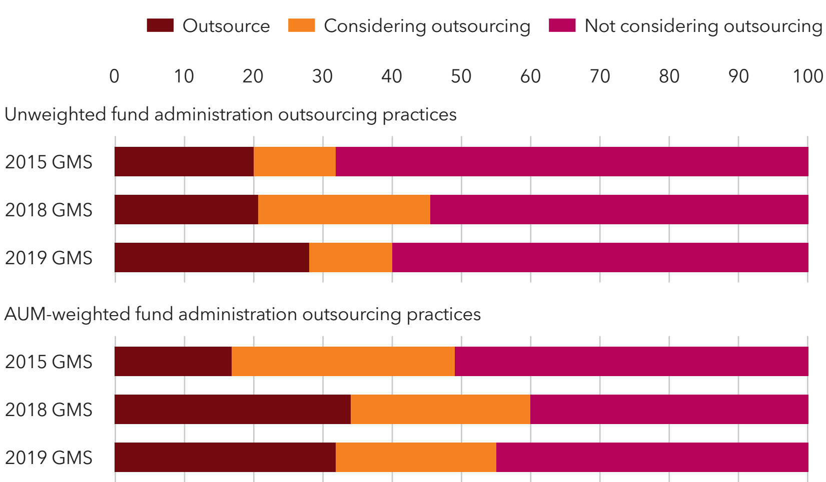
"Fund administration requires an increasing investment in tech; managers seem inclined to leave that to specialists"

ZOE HUGHES
NAREIM

Zoe Hughes: Does size matter, when it comes to outsourcing? Is this something that smaller and mid-sized companies will typically do, while larger firms have the scale to do such services in-house?

EG: If you look at the responses to this question on an assets under management-weighted basis, in 2015 we see 17 percent of firms outsourcing, compared with 20 percent on an unweighted basis. So not a material difference, but a slight bias toward smaller firms. If you look at the 2019 results, the figures are 28 percent unweighted and 32 percent AUM-weighted. What that tells you is there is a shift not only in the pure number of firms moving to an outsourcing model, but we are also seeing more and more of the larger firms move to an outsourced model.

Fund administration outsourcing has seen a steady rise since 2015 (%)



Source: Outsourcing Practices: Observations from the NAREIM/FPL Global Management Survey

Talking shop:
Erin Green, left, and
Zoe Hughes

ZH: If scale is not a primary factor in outsourcing, what are the primary motivations? Anecdotally, NAREIM members seem to want to use outsourcing to help them focus on their core competences. How have the motivations driving outsourcing changed over the past three or four years?
EG: The rationale for outsourcing has certainly evolved over the last few years. However, as you say, the number one reason is the desire to focus on core competencies, which was cited by 91 percent of firms. Even large firms, which could have an in-house team, have this desire to focus on the things that really drive their business and which make them successful.

Interestingly, transparency was cited by 70 percent of firms, whereas the first year we asked this question, only 50 percent highlighted that. This derives from a broader trend of investors wanting more transparency, more oversight. Having a third party responsible for actually calculating fund returns and pulling together the numbers is a strong message about transparency for investors.

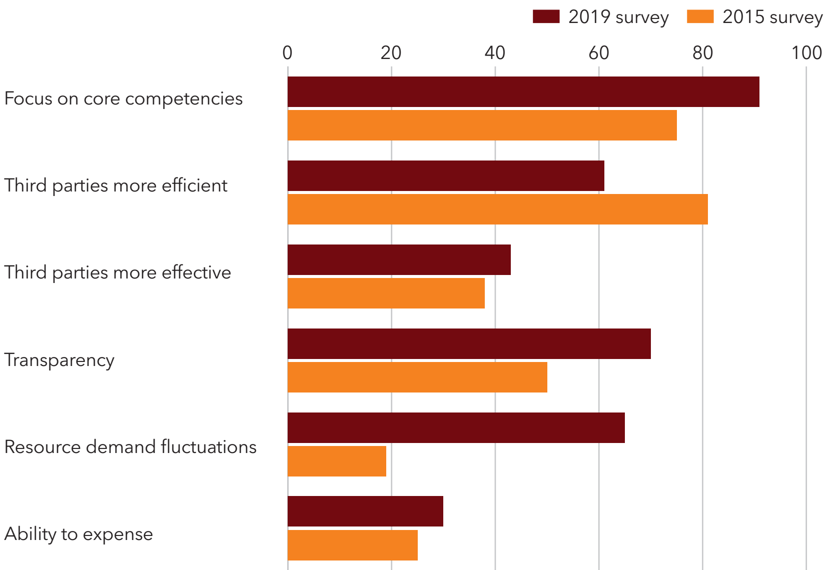
Complexity drives outsourcing

ZH: One of the things we are seeing is a desire among managers to diversify their product offerings, whether that means going up and down the risk spectrum, or equity players moving into debt and vice-versa. Is real estate investment management becoming a more complex business and thus encouraging more outsourcing?
EG: I think you are exactly right. Product diversification has been a key trend, so managers have more vehicles and more disparate strategies. Without a doubt, that has brought a whole new level of complexity into the fund administration activities of the average manager trying to do these things in house. Also, the service providers have been getting better and better at dealing with real estate investment managers. There are now a number of service providers that can really bring an excellent level of service to the table, which was not necessarily the case a decade ago.

> *"There are now a number of service providers that can really bring an excellent level of service to the table, which was not necessarily the case a decade ago"*
>
> **ERIN GREEN**
> **FPL Associates**

ZH: Technology also seems to be a factor; it is becoming a more integral part of a real estate investment manager's business and naturally this increases pressure on finances. Fund administration also requires an increasing investment in technology, so it seems managers are inclined to leave investment in that to specialists and focus their investment on tech in their core areas.
EG: Absolutely; if you are going to keep up on the fund administration side, there are some significant investments in technology that you have to make in order to keep up with the complexity of the business. An outsourced service provider will be providing these services for a number of real estate companies, so they have a scale advantage over the individual manager. And of course it is their core business they are investing in managnig the relationship.
ZH: Managers often ask, what is that right level of outsourcing when it comes to fund administration? And of course, even when a manager outsources this function, it does not mean it can be forgotten. A question that has been regularly raised at some of our NAREIM meetings is: how do you ensure effective oversight of your third-party partner?
EG: I think it is hard to say what the 'right' level of outsourcing is. For every firm, there will be a continued individual assessment as

Managers' primary motivations for outsourcing (%)*



* Data reflects managers that already do or are considering outsourcing

Source: Outsourcing practices: Observations from the NAREIM/FPL Global Management Survey

Outsourcing: The manager's view

Real estate investment managers are outsourcing more than just fund administration; other commonly outsourced functions include audit, valuation, IT and specialist real estate functions

For some managers, outsourcing to a specialist saves the cost of recruiting and managing an in-house team, as well as providing access to skills and organizations which work across multiple funds and jurisdictions. Outsourcing also allows managers to focus on what they get paid for: investing in and managing property.

Regardless of what function is being outsourced, there are a number of common priorities. As one investment manager says: "Key factors include expertise in the relevant jurisdictions, reputation, cooperative history, team capabilities, technological capabilities and, of course, fees."

Chris Wu, finance director of Chongbang, a specialist in retail-led China mixed-use real estate, offers some advice for managers: "You need someone in-house who has ownership of the relationship with a service provider; outsourcing should not be seen as handing off an unwanted task or function to an outside service provider."

Managers stress the importance of building a partnership with their service providers. Wu says: "Where there is a long-term outsourcing relationship there needs to be a partnership with the service provider and an entrepreneurial spirit, as we grow our businesses together."

Another manager adds: "Values are more important than costs."

While the functions that real estate investment managers outsource might not be core competencies, they are important, and so is troubleshooting. "There are a number of factors which might be a concern in an outsourcing relationship, whether it is ongoing or new," Wu says.

"Firstly, continued non-delivery is an obvious red flag but we would also be concerned about a change in ownership, especially one that saw key staff leaving. High staff turnover is also a warning sign."

to what makes the most sense for your platform. However, I believe the trend will continue as more firms really try and focus on their core competencies and as those outsourced service providers continue to boost their services.

Now, if you are a real estate investment manager, it does not mean that because you are outsourcing fund administration, you get to forget about it! There has to be a level of engagement and cooperation with that outsourced service provider. There are four things that we generally highlight. Number one is there has to be a point person, an owner of the relationship internally, and that should be somebody of seniority within the organization.

Number two is having very clearly defined expectations and, in the initial contract, having very clearly stated objectives. Number three, you then have to hold your outsourced service provider accountable to those things. Finally, you need to pull in key stakeholders, the people who have to use the work product of your outsourced service provider or who interact with them on a day-to-day basis. That point person needs to be proactive about taking the temperature among the people who interact with the service provider. That type of information is really important in forming a holistic view of how effective that service provider really is.

What does the future hold?

ZH: Looking to the future, one thing we see from the survey is that the percentage of those considering outsourcing has declined from 32 percent in 2015 to 23 percent in 2019. Are we coming to an inflection point in terms of the industry deciding whether to outsource or not? What will the future trend be?

EG: I think that there are certainly more firms which have made a decision, but there is a continuous evolution here. Some firms are scaling up and they will get to a point where they say: "Maybe we should reconsider our approach." And likewise, there will be others that decide to bring fund administration in house. However, the main reason the percentage of firms considering outsourcing has fallen is that the percentage of firms actually outsourcing has risen. I absolutely expect this to continue. For example, we know of a couple of prominent, very large-scale managers which are actively working towards outsourcing. So we will continue to see more firms across the industry move down this path." ■

View from the C-suite

Evaluating the employer value proposition is paramount, PATRIZIA's head of human resources, Simon Woolf, tells PERE

Q What prompted your appointment and how is the HR function evolving within the real estate fund management firm?
PATRIZIA has strengthened its European footprint in recent years to become a major player internationally. The board regards the company's people agenda as being a crucial element in supporting the company's growth. My role is to ensure we have the talent in place to support this growth and ensure PATRIZIA remains an employer of choice. My experience from outside the real estate industry was also important. I was previously head of human resources for a major music corporation, an industry that reinvented itself due to digitalization. The real estate sector is on the cusp of that journey, which presents an exciting opportunity.

Q What single activity or aspect of your role takes up the most bandwidth on a daily/weekly basis?
I only joined PATRIZIA six months ago, so it is early days, but my initial focus has been to ensure we have the infrastructure and processes in place for HR to manage talent on a global scale and in a rapid way. We are developing exciting plans for PATRIZIA's progressive talent agenda, but to do that we need the infrastructure first.

Q What HR issues keep you awake at night?
Attitudes to the working environment are changing. People are more environmentally and socially aware, and we need to support our employees in achieving that. I see that as an opportunity, not a worry. We are currently evaluating our employer value proposition to understand what current and future generations really want and expect from an employer. That touches everything from flexible working, working in an 'always on' digital environment, to generations which are less focused on the modern, traditional hierarchical routes of career progression. It is about creating the life opportunities people are looking for from employers.

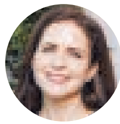
"Automating systems using AI and analyzing that data has the potential to really change and enhance people management capabilities"

Q What is the least understood aspect of the HR function in real estate fund management firms?
The potential to really harness the power of the brand by living and breathing the culture is a really powerful tool for the people agenda. People analytics is another area, which every sector, not just real estate, is grappling with. Automating systems using AI and analyzing that data has the potential to really change and enhance people management capabilities. It is an important tool for organizations but no one has found the silver bullet yet.

Q Technology and data skills are becoming critical in real estate investment. Is it a challenge to hire for these roles?
Technology, innovation and digital capability are areas we are very much focused on building out as an organization, but it is a combination of building our own internal function while also bringing in experts from outside to help. Being a relatively new skill set, recruiting talent in the area of big data and analytics is tougher. We find it less challenging to hire technology roles.

Q What lessons have you learned in your role?
The trick is to be super professional and client-centric. Understand the business, understand the business strategy and what you are trying to achieve, and make sure your people agenda aligns to that. Real estate is a people business, you need excellent people for doing excellent business. A people strategy built in isolation is meaningless. Listening and getting close to the business, understanding how each business unit operates and the interconnectivity is crucial. ■

How to hold on to your C-suite executives



Guest comment by **Emily Bohill**

When it comes to retaining talent, some things matter more than money, writes the managing partner of executive search and advisory firm Bohill Partners

Business development and investment professionals are the face of an investment firm, but what has been traditionally called the 'back office' is the heartbeat of the business – much quieter and much less visible to the outside world, perhaps, but equally important in making a firm function.

Attracting and retaining the best people for these roles is competitive and in an age of downward pressure on fees, throwing money at the problem is not the best answer. When we interview candidates for senior roles in these areas of the business, three factors regularly rank above compensation as reasons for looking elsewhere.

Appetite for change

Many of these roles contain plenty of routine work – most CFOs admit that overseeing accounts is not the most fulfilling part of their role – but what really makes a position exciting is the opportunity to drive change. The best talent will have the initiative and good sense to identify these projects themselves, so what a CEO must do is create an environment where people are encouraged to go above and beyond. While there cannot always be an M&A integration or a systems transformation project to manage, business as usual is simply not of interest for the most dynamic people in these roles. One COO that Bohill Partners recently placed to an asset manager was open to moving because their previous firm was "perfectly happy to keep on doing what they were doing" despite seeing plenty of opportunities for further growth.

Recognition

People in these roles who are looking to move on, even those right at the top of the organization, are often frustrated that so-called 'front office' professionals do not appreciate the importance of their work. "We're just seen as a cost center," is a common complaint. In some organizations, this even extends to the office space – sitting the investment team in a separate, much more lavish floor or building is not the best way to show the rest of the firm they matter. Showing how they contribute to the overall success of the business, both to them and to their colleagues, goes a long way in making them feel valued. Having a two-tier organization does not. Senior leadership needs to model this behavior, by publicly congratulating them on big achievements and explicitly linking them to the overall success of the business.

Listening

More are seeking input from previously overlooked parts of the business to make key decisions, so if you want HR to contribute more than just administering payroll and firing people, and legal to work proactively alongside you rather than being a blocker, then include them in the big conversations. It is a virtuous circle: letting them understand how you, the CEO, and the investment team are thinking gives them a better understanding of what you are trying to achieve. This allows them to contribute more effectively, which encourages the rest of the business to include them more frequently, and in turn allows them to learn more, and so on. This can be replicated right down the organization. The key change in mindset that needs to happen is that the investment team are requesting the expertise of whichever team it happens to be, not simply barking out orders.

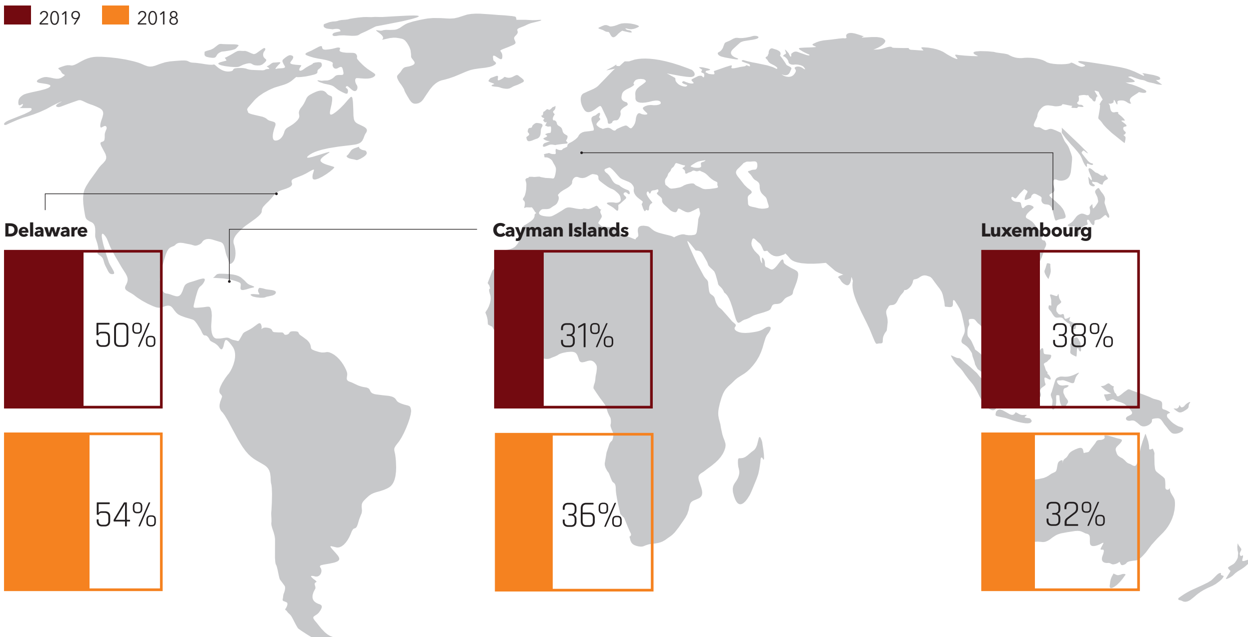
Ultimately, this all boils down to creating the right corporate culture – as a leader, this is a key part of your job. Encourage the right kind of positive, open and appreciative atmosphere and you will be much better placed to attract and retain the best talent throughout the organization, without spending any more of those hard-earned fees.

The cost of replacing a highly skilled employee can be up to three times their annual compensation, including recruitment fees, onboarding and training time, and the gap between them leaving and having a new person in place. So spending a little more time ensuring they are given the right environment is a good investment. ■

Fund admin perspectives

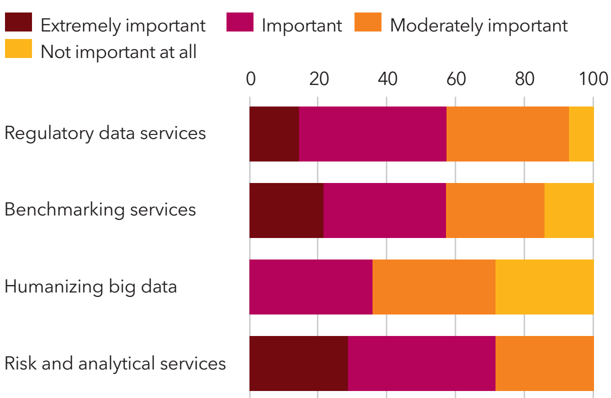
Throughout 2019 PERE has surveyed managers and investors for their views on fund domiciles, data management strategies, outsourcing, fees and due diligence and more. Here are some takeaways

Top three domiciles chosen by managers for their next private real estate fund



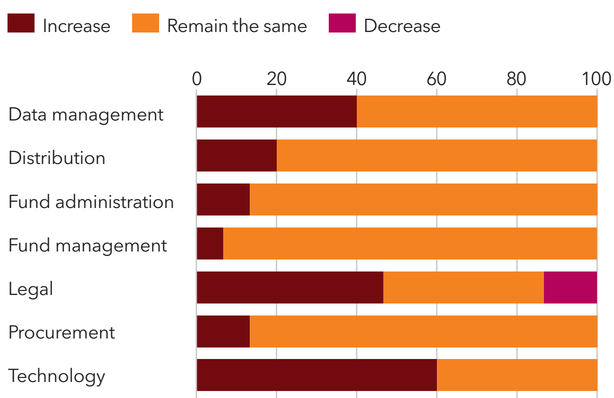
Source: PERE Manager Survey 2019 (respondents asked to select their top three from a list of 17)

How important are the following data management strategies to your firm? (%)



Source: PERE Fund Manager Survey 2019

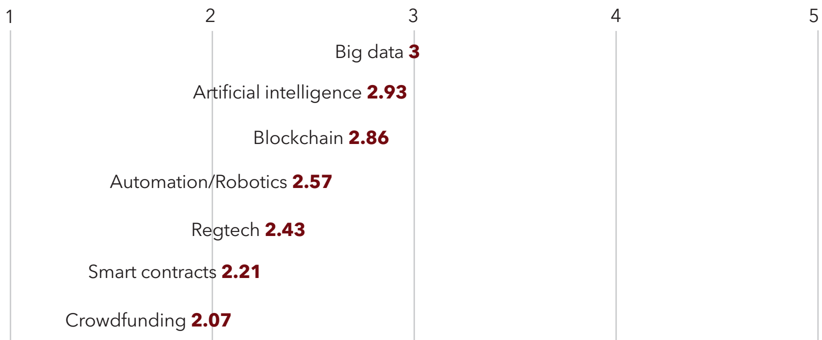
How will you approach outsourcing of the following areas over the next 12 months? (%)



Source: PERE Fund Manager Survey 2019

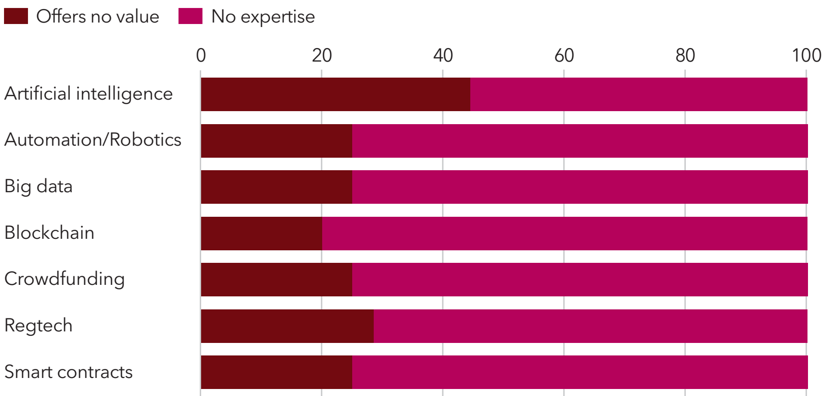
What is the potential for the following to disrupt the private real estate capital investment and service space in the next three years

1 low potential, **5** high potential



Source: PERE Manager Survey 2019

If your organization is not planning on implementing any of the following, what is the biggest reason? (%)



Source: PERE Manager Survey 2019

Automated waterfalls

Private fund CFOs express doubts about new technology for calculating distributions

Automated for the people?

- Did not automate their waterfalls
- Automate using a third-party provider

Why not automate?

- It was too expensive
- Our waterfall is too simple
- Our waterfall is too complicated

Source: Private Funds CFO (based on anonymous interviews with 15 CFOs)

66%

Investors saying they want greater fee transparency and disclosure from their managers in the last 12 months

63%

Investors that believe manager fees are difficult to justify

58%

Investors that report a manager's succession and retention plans form a major part of their due diligence

5%

Investors that say the gender pay gap at the manager level is a major part of their due diligence

37%

Investors that place ESG as a major consideration during fund due diligence

45.2%

Investors cite this LPA term as the most contentious with managers

Source: PERE Investor Perspectives Survey 2019