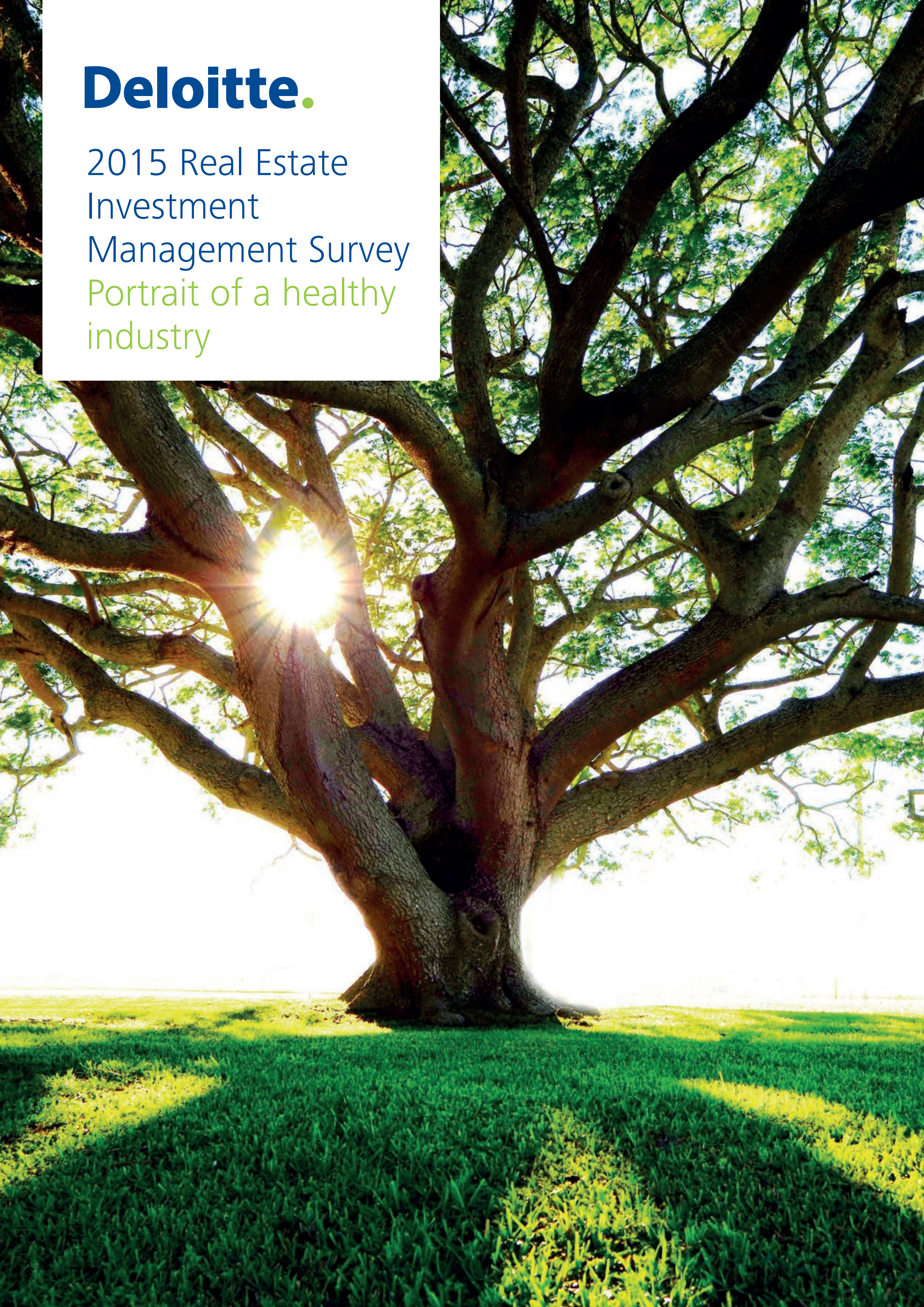
Deloitte.

2015 Real Estate Investment Management Survey

Portrait of a healthy industry



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Executive summary

The Deloitte 2015 Real Estate (RE) Investment Management Survey portrays a healthy industry that is currently adapting to new business paradigms and patterns–both those imposed by regulations and those requested by investors.

The attractiveness of RE as an asset class has returned to pre-crisis levels. Sovereign wealth funds are increasing their weight in an industry that is still largely dominated by pension funds and insurance companies: traditionally the two biggest investors. Allocations to RE are increasing at both European and global level, intensifying the competition managers have to face in order to deploy their strategies and find the right assets.

Competition in deal selection and execution is the common denominator throughout the survey: managers who have successfully raised capital in the last 18 months must now deploy their investment strategies by finding the right assets to achieve the targeted performance. The arena is crowded and the high pressure experienced by managers means that most of them are changing their traditional business. Some are shifting from core to core plus strategies, others are entering new asset classes to broaden their product offering and others still are opening or closing offices to reshape their footprint. Yet another group is conducting more pan-European, U.S. and Asian investment, or opening offices, investing and marketing in new countries. They are already international but they need global partners to support their business's global growth.

To support these changes, a large number of mangers are rethinking their IT tools with a view to improve operational efficiency by implementing systems to either monitor fund activities across the whole fund life or to better control RE assets. Regardless of the scope, the RE industry is looking for solutions which can promote–if not reinforce–standardization in the way operations are carried out. In this respect, investor reporting is playing a major role in paving the way for the implementation of IT tools. Indeed, while industry standards such as INREV are becoming increasingly popular and gaining wider recognition as best practice, reports are still largely produced manually, if not on an ad hoc basis. Managers tend to answer specific questions with specific reports, preparing manual reconciliation and extracting ad hoc information: hence the need for the standardization that dedicated IT tools would offer. Last but not least, the regulatory burden imposed on managers by AIFMD is still on top of their agenda. Questions remain over AIFMD implementation and how to structure corporate governance to reduce duplications and costs (valuation oversight, distribution, relationship Manco-AIFM, etc.). In particular, regulatory compliance is an issue for managers who are not equipped to follow the latest developments.

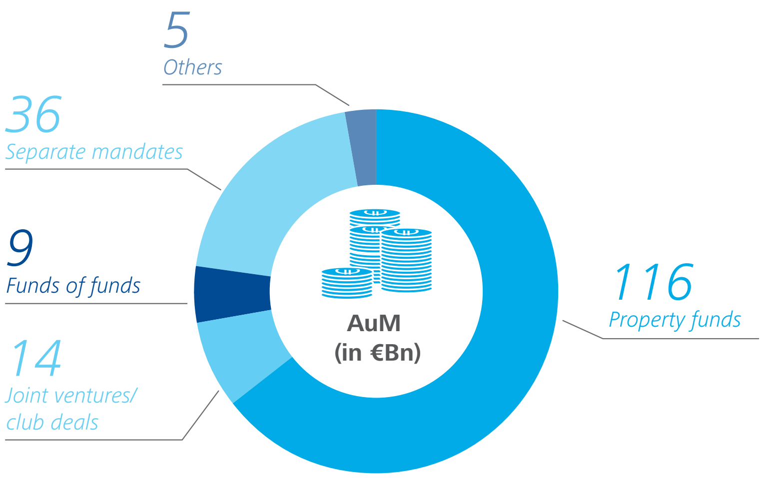
Overall, the prevailing sentiment is quite positive. Strategic and operational challenges have been identified; most innovative players are already turning them into opportunities that will shape the immediate future of the industry.

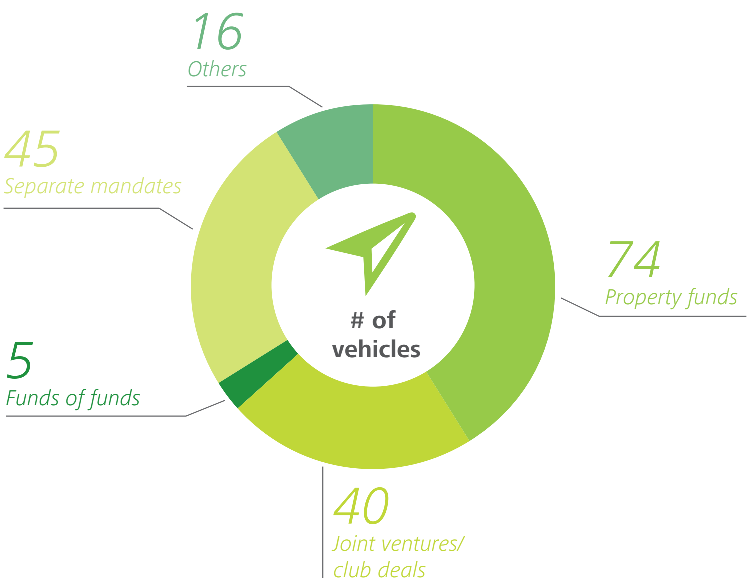
Introduction

ASSETS UNDER MANAGEMENT IN RE

Total Assets under Management (AuM) in Europe

The survey represents approximately 180 vehicles with asset under management amounting to €200 billion. Totaling €116 billion, property funds are the most popular vehicle and account for approximately 68 percent of the total AuM covered in the survey, followed by separate mandate (€45 billion, 18 percent) and JV/Club deals (€14 billion, 7 percent).





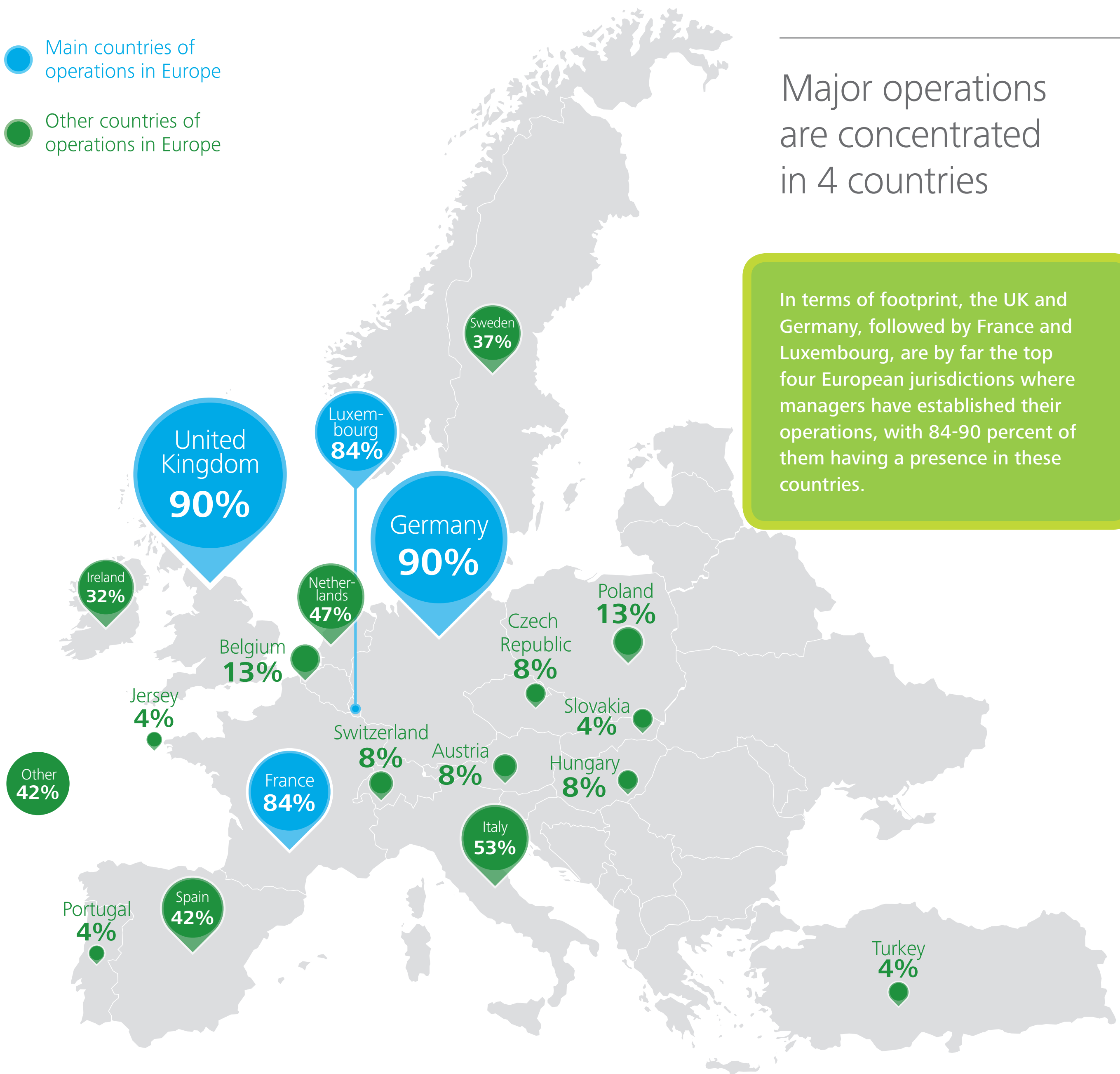
The 2015 Real Estate Investment Management Survey (the survey discussed below) covers the top 20 global real estate investment managers with European assets under management of €200 billion and addresses some of the most relevant industry trends, with an outlook over the next 24 months. The survey gives an overview of the most relevant challenges that the industry is currently facing and in particular it focuses on how RE investment managers have addressed regulatory changes, taxation, investor reporting and portfolios.

It also provides an insight on operational models.

- RE investment managers are optimistic about access to capital
- Transparency is top of investors' requirements, second only to performance
- AIFMD has been an opportunity to review operating models, now the priorities are simplification of processes and leveraging the license to further support the business
- 63 percent of survey respondents believe their current real estate IT systems need improvement
- Nothing has changed in terms of target markets, with Germany, the UK and France still dominating managers' investment strategies

Property funds comprises a significant portion of the total AuM

EUROPEAN FOOTPRINT



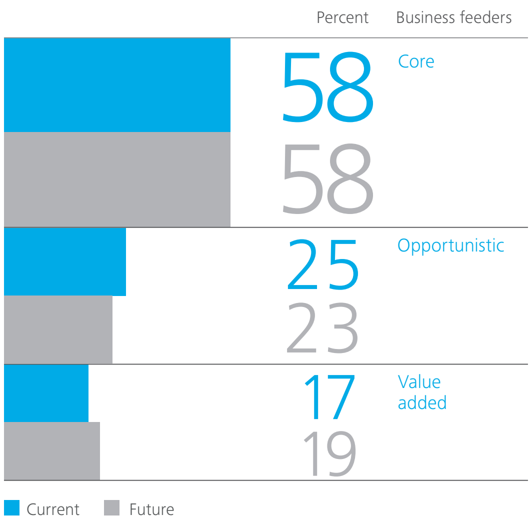
Major operations are concentrated in 4 countries

In terms of footprint, the UK and Germany, followed by France and Luxembourg, are by far the top four European jurisdictions where managers have established their operations, with 84-90 percent of them having a presence in these countries.

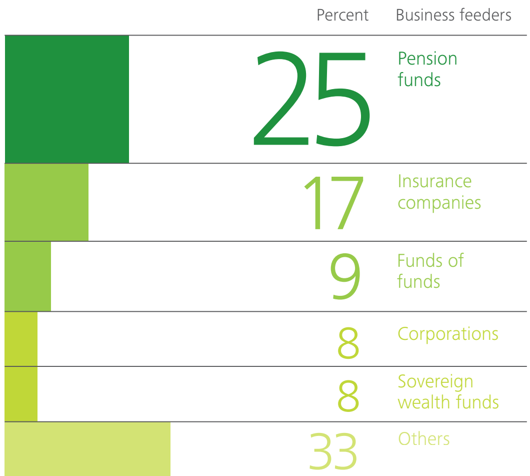
General overview

MAIN BUSINESS FEEDERS AND INVESTMENT RESTRICTIONS

Investment strategy



Main business feeders



The majority of managers' strategies are focused on core (58 percent) and it will very likely remain that way in the future, while there will be a small shift from opportunistic to value-added (by -2 to 23 percent). The latest INREV Fund Manager Survey[1] seems to confirm this allocation, with core at 61 percent, followed by opportunistic (27 percent) and value added (12 percent).

Core strategies largely dominate the landscape because more than 40 percent of RE investors are represented by pension funds and insurance companies, which are by far the largest business feeders of the industry.

Such investors seek to secure stable long-term income with relatively low risk exposure in order to match their balance sheet liabilities, and core strategies fully meet these requirements.

Pension funds are the main business feeders for RE investments (25 percent), followed by insurance companies (17 percent), funds of funds (9 percent), corporations (8 percent), sovereign wealth funds (8 percent), wealth management (8 percent), charities, foundations, non-profit organizations (6 percent) and government institutions (6 percent) combined.

1 ANREV/INREV/NCREIF Fund Manager Survey 2015

INVESTOR ALLOCATION

39%

NORTH AMERICA

39%

EUROPE

12%

ASIA

11%

MIDDLE EAST

Investors in RE are mainly from Europe and North America

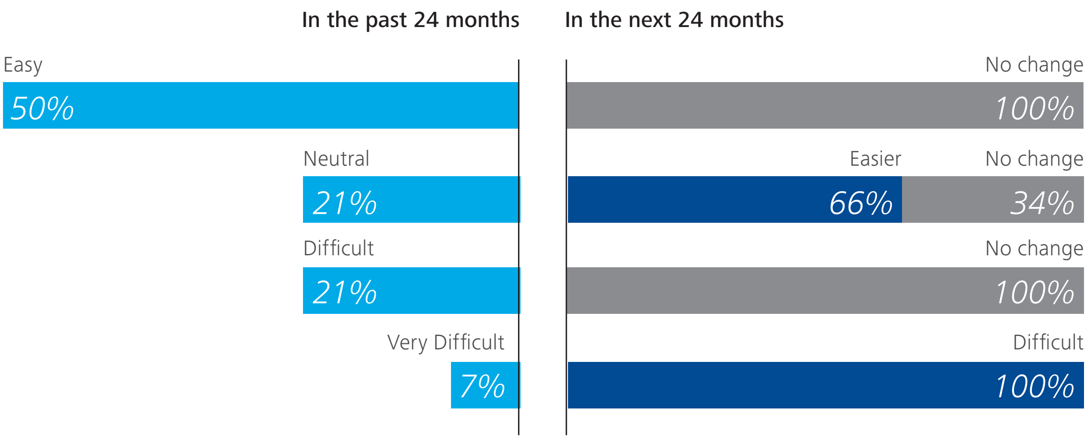
European and North American investors currently represent almost 80 percent of all industry feeders, with Asia and the Middle East counting for slightly more than 10 percent each.

FUNDRAISING

When it comes to fundraising, two distinct trends exist: on the one hand, half of the managers surveyed have enjoyed "easy" access to capital over the past two years while, on the other hand, 28 percent described it as either difficult (21 percent) or very difficult (7 percent). It is interesting to note that neither group expects changes in the coming 24 months, suggesting that the market runs at different speeds: those who were able to attract money more easily will continue to do so, while others will struggle to secure commitments from investors.

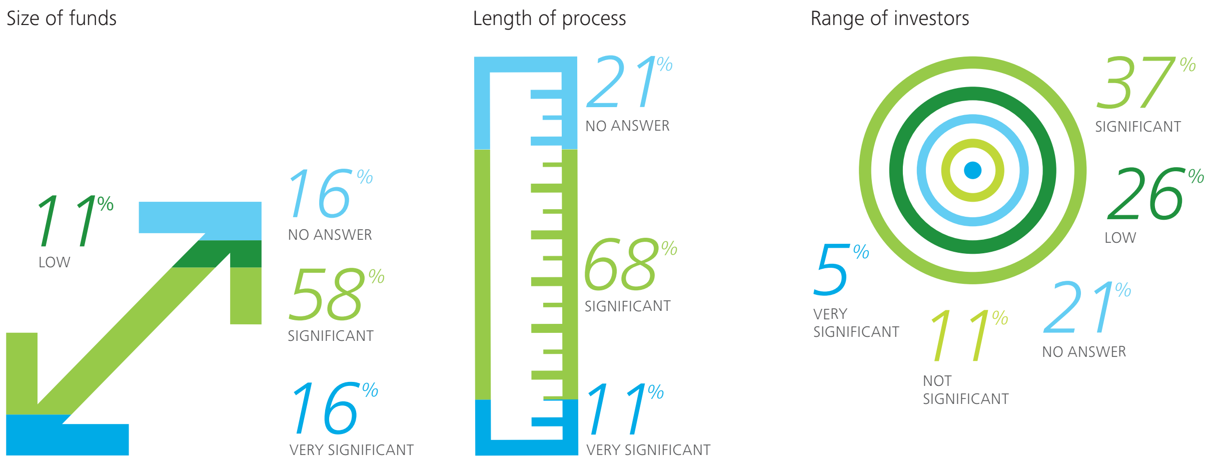
This trend seems to confirm Preqin's 2015 Global Real Estate Report findings: 72 percent of RE investment managers said they had seen an increase in competition for investor capital compared to 12 months ago. The report also states that fundraising will continue to be particularly difficult for newer firms, since investors are increasingly drawn toward RE investment firms with a long and strong track record.

Track record, past performance and IRR are indeed a "must" for 94 percent of investors when selecting their managers, followed by increased transparency (78 percent) in the form of information at property level and bespoke reporting through the entire life of the fund. Less important factors include fees (44 percent) and managers' skills and expertise (28 percent), their market knowledge, the stability of the team and the alignment of interest. The relatively low interest in the management team may be attributed to the high attention on performance, which constitutes a better synthetic assessment of the team itself than any other: the best teams will generate higher IRR and returns than the market average and hence performance is already an indicator of the team's strength.



FUNDRAISING CHALLENGES

Level of impact on the fundraising process



Investors have increased capital allocation to RE but have also raised their level of requirements

Tailor made reporting requests outside of the regulatory framework

Over the last two years, investors have increased capital allocation to RE–which was closer in 2014 to 2007 levels[2]–but also raised the level of their requirements.

During fundraising, the length of the process (79 percent) and the size of the fund (74 percent) are the most relevant factors: once an agreement is signed investors want the capital to be deployed quickly.

Fund size is critical for at least three reasons: bigger funds can spread risks over a larger number of assets, they can benefit from economies of scale (especially in their operations) and investors can allocate higher commitments, while keeping very small stakes; many investors have indeed restrictions on the stakes they can take in funds.

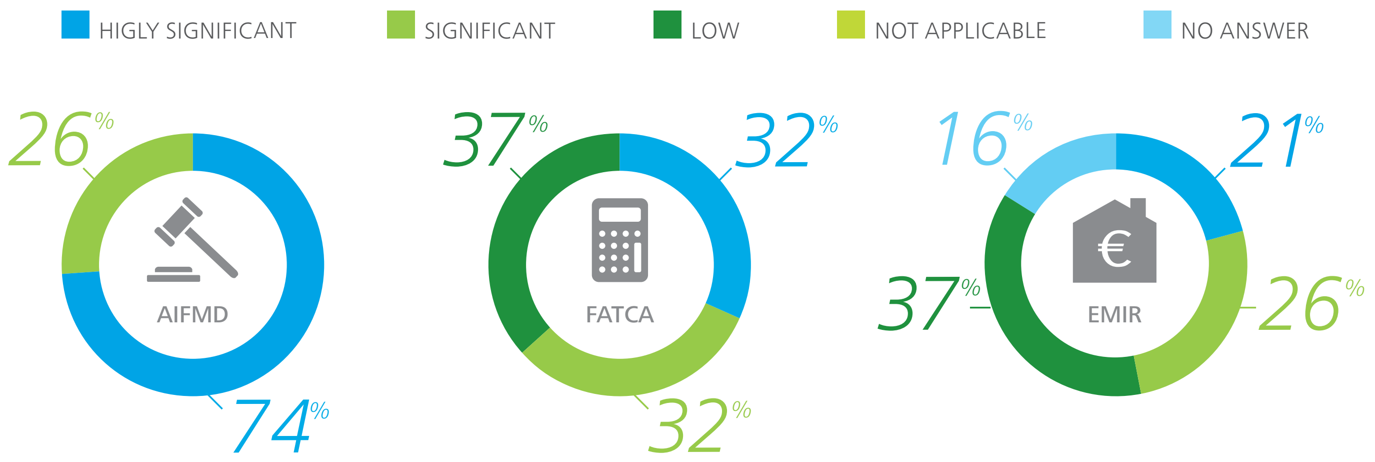
Over the life of the fund, 89 percent of managers receive multiple "tailor-made" reporting requests from investors in addition to the standard regulatory ones. Such requests are often unique and specific, while the most common and standard are INREV and IFRS.

2 INREV Capital Raising Survey 2015

AIFMD remains a key regulatory concern for RE investment managers

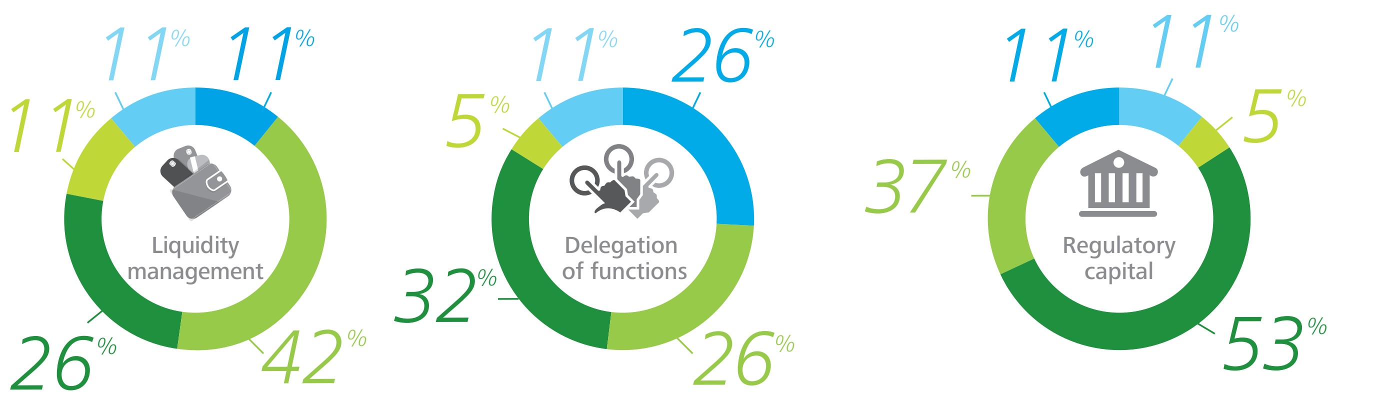
REGULATORY CHANGES

Impact of regulatory changes on the organization



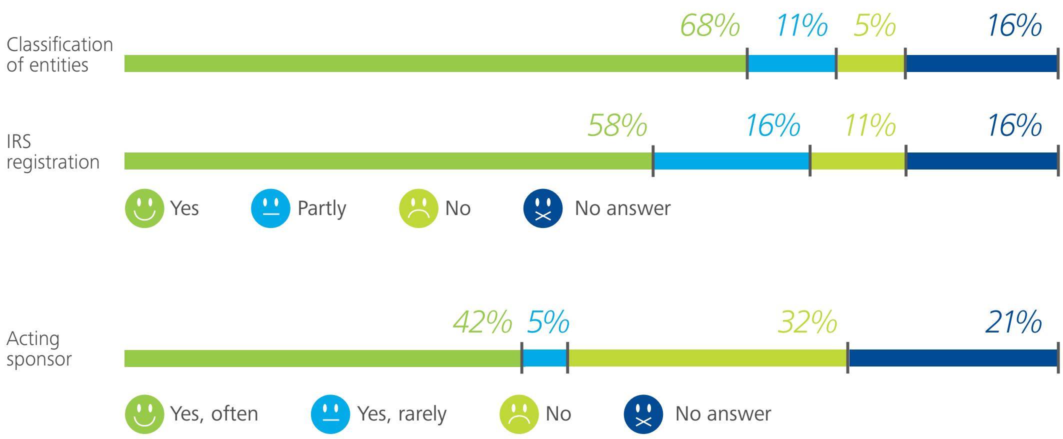
AIFMD PROVISIONS

Impact of AIFMD provisions on the organization



The past few years have seen RE funds, like all alternative investment vehicles, affected by a wave of regulations most notably including AIFMD. All investment managers confirmed that the Directive had a “very significant” (74 percent) or “significant” (26 percent) impact on their organizations: moreover, it forced investment managers to reconsider the way they were operating–this is especially true for the 72 percent who deemed it necessary to review their operating models and governance structures in order to comply with the Directive requirements.

FATCA CLASSIFICATION AND REGISTRATION



The second set of regulations with the greatest impact on RE investment managers was FATCA: it had a "very significant" or "significant" impact for two-thirds of the managers who answered our survey. 68 percent of them have completed classification of their managed entities and 58 percent have registered these managed entities with the IRS. Such actions are viewed as indicators that investment managers have promptly analyzed and are developing implementation plans for FATCA compliance: indeed, almost 80 percent of them are confident in their own compliance onboarding procedures and many of them have gone to great lengths to put structures and resources in place to comply with the U.S. regulations. In terms of reporting, the level of readiness is lower; however, 63 percent describe themselves as either "very prepared" (16 percent) or "prepared" (47 percent)[3].

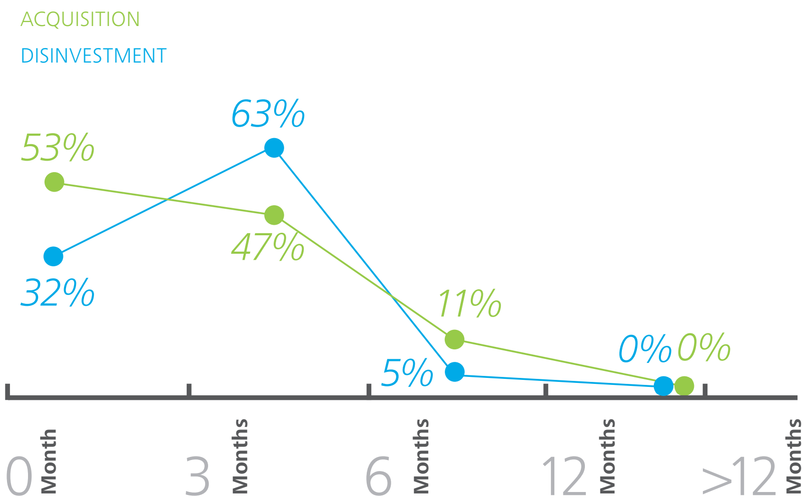
3 For a better interpretation of the Survey results, it is important to remember that it was conducted in Q1 2015

Investment portfolio

INVESTMENT ACQUISITION AND DISINVESTMENT

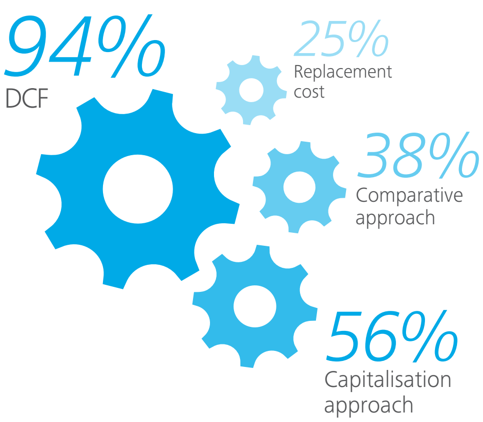
The process on the average takes less than six months to complete

We noticed that one key requirement for investors during fundraising is the length of the process: this is even more important in light of the fact that on average it takes three months for 53 percent of managers to buy an asset, and up to six months for 47 percent of them. For divestment, the situation seems to be the opposite: only one-third of managers can complete a transaction in less than three months, while it takes up to six months for two-thirds of managers to sell an asset.

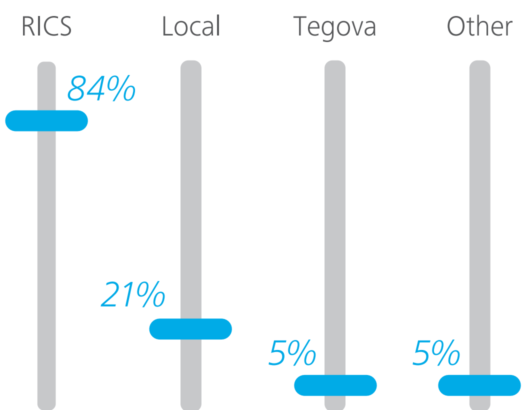


VALUATION STANDARDS AND METHOD

Method applied



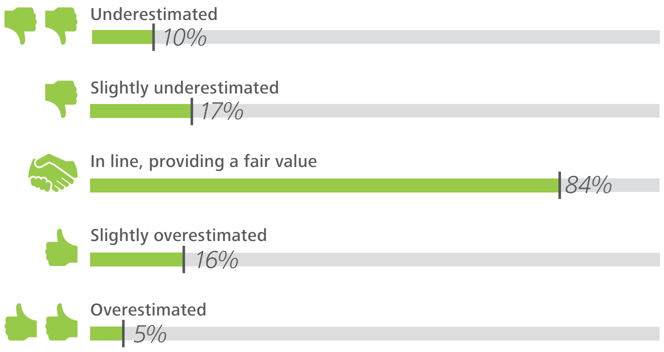
Valuation standards

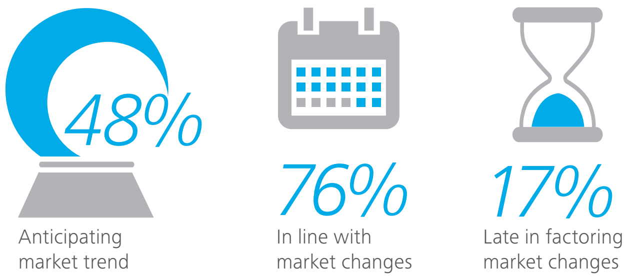


RICS are by far the most adopted valuation standards, used by 84 percent of the managers: discounted cash flow is the most popular valuation method used in the industry (94 percent) followed by capitalization (56 percent) and comparative approach (38 percent). Only one out of two managers use two methods in their asset valuation, the remaining 50 percent use one single method.

EXTERNAL VALUATION

Values provided by the independent valuation experts





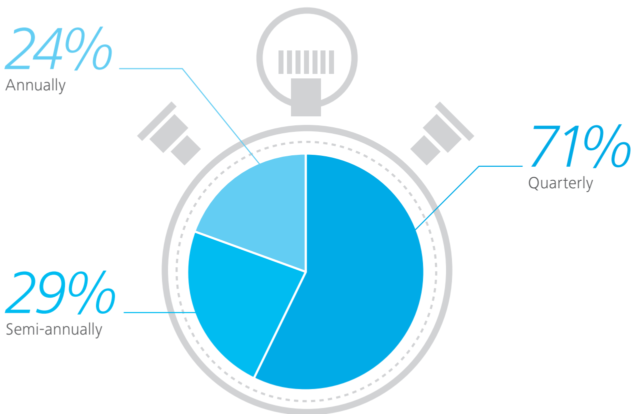
Third-party valuations are generally in line with fair values and market changes. Fair values are in line for 84 percent of cases; the remaining values are either underestimated (27 percent) or overestimated (21 percent).

In addition to being in line with fair values, the majority of values also reflect market changes: in 48 percent of cases, valuations from independent RE appraisers anticipate market trends, while they are only late in predicting factory market changes in 18 percent of cases.

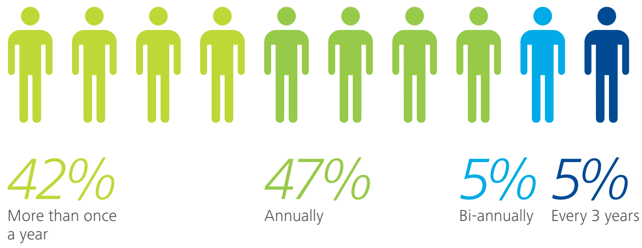
Most of the RE funds are priced quarterly and, unsurprisingly, valuation is performed with the same frequency for 71 percent of survey respondents. Semiannual and annual valuations are carried out by 29 percent and 24 percent of managers respectively (some managers provide more than one choice since different funds/properties may be valued more frequently than others).

FREQUENCY OF VALUATION AND SITE VISITS

Time of valuation



Frequency of site visits

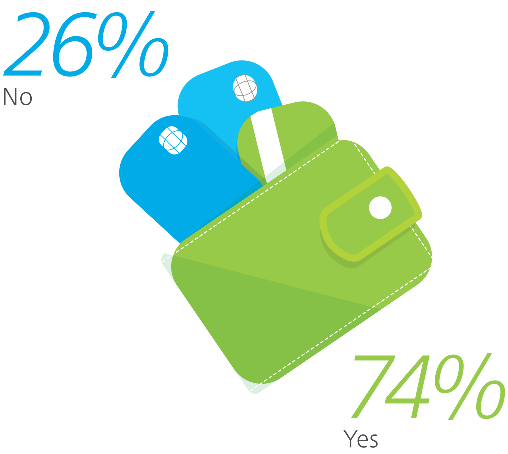


Property visits are carried out at least once per year as part of continuing due diligence and monitoring activities in 90 percent of cases. However, there are a few survey respondents who arrange asset visits less frequently.

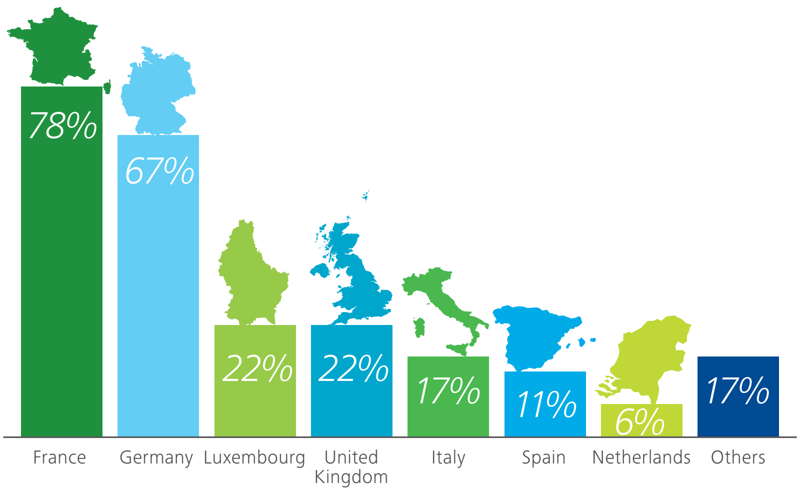
Taxation

INFLUENCE OF TAX REGIME

Influence of tax regime in looking for investments

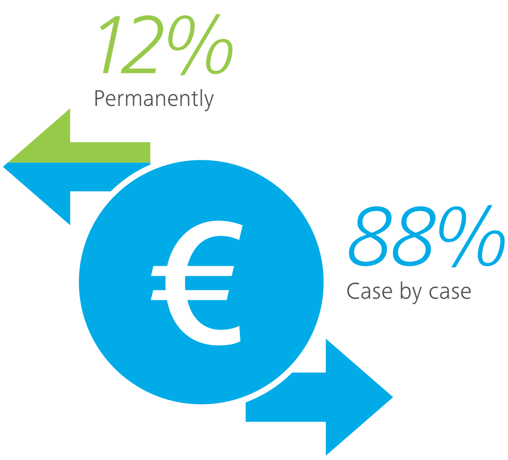


Countries where tax authorities have increasingly challenged cross border tax benefits

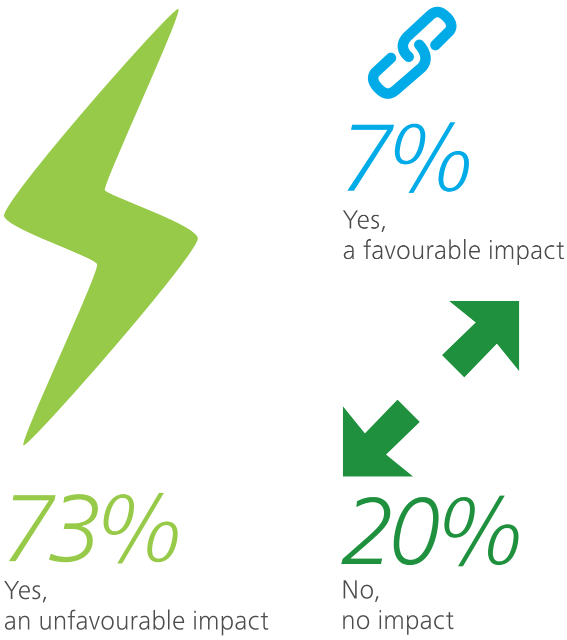


TRANSACTION TAXES AND FISCAL NEUTRALITY

Fiscal neutrality considered a key driver for investment

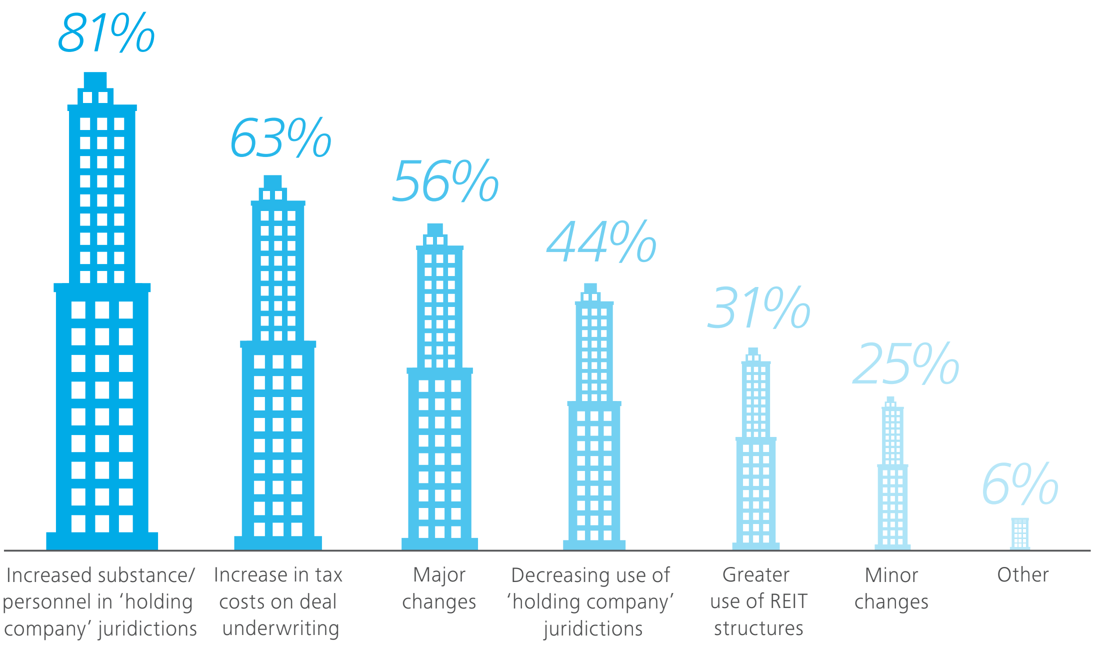


Impact of transaction taxes on RE



BEPS IMPACT

Expected changes from the BEPS implementation



A country's tax regime plays a crucial role in the selection of investments: 74 percent of managers confirmed that tax regimes are influential when they look for investments. Not surprisingly, RE transfer taxes have an unfavorable impact on performance for 73 percent of respondents, while they unanimously view fiscal neutrality as a key driver for performance: 88 percent of managers consider it on a case-by-case basis, while 12 percent always factor it into investment decisions.

Also from a tax perspective, additional regulations have already made and will continue to make an impact on the industry. France and Germany are the two countries where tax authorities have increasingly challenged cross-border tax benefits, for 78 percent and 67 percent of respondents respectively, followed by Luxembourg and the UK (22 percent). In reading these results, we need to remember that Germany, France and the UK are the countries where most RE funds invest; it is therefore more likely that tax challenges will come from these countries than from others.

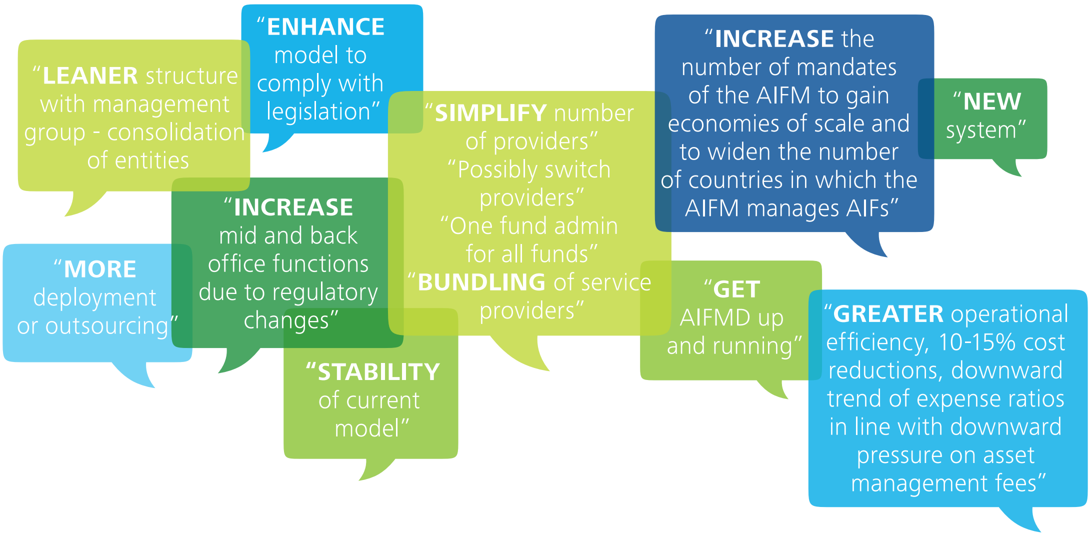
On an international level, measures taken by BEPS are highly likely to urge RE investment managers to change their approach to holding structures, despite the fact that the impact on the operational model is not yet defined and is still a topic for debate within the industry.

For 56 percent of participants, BEPS will have a major impact on the industry and will primarily drive a 'substantial' increase in most holding company jurisdictions (81 percent), which will probably lead to an increase in the tax costs of deals (for 63 percent). Almost half of participants anticipate a decrease in the use of the "holding company" jurisdiction and one third expect an increase of REIT structures. Finally, 25 percent believe that the impact on the industry will be minor.

Other operational aspects

OPERATING MODEL

Key priorities on operating models in the next 12 to 24 months



Level of satisfaction with operating model

AIFMD has forced managers to review their operational framework to respond to and comply with the Directive requirements. Most respondents have successfully completed this exercise: only 17 percent feel that their operating model needs improvements, while two-thirds of respondents are either 'very satisfied' (17 percent) or 'satisfied' (50 percent).

Operational priorities for the industry are heterogeneous, but most are built around the implementation of the Directive, such as reducing the number of service providers, reducing operational costs to offer more competitive management fees, and increasing the number of AIFM mandates to gain economies of scale and benefit from the passport.

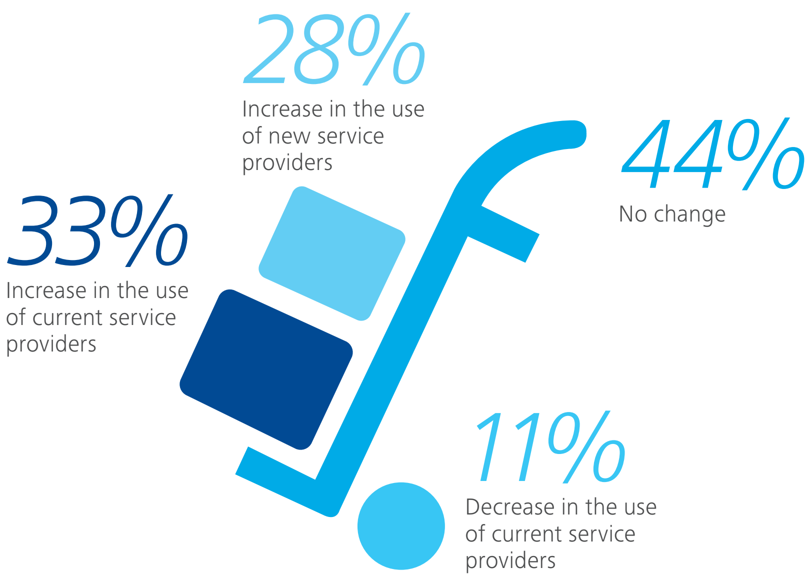
AIFMD has forced managers to review their operational framework to respond to and comply with the Directive requirements

RE is an inherently local business and as such it requires local expertise, mostly at property level

USE OF SERVICE PROVIDERS

Average number of service providers used

Expected change in the future on the use of service providers

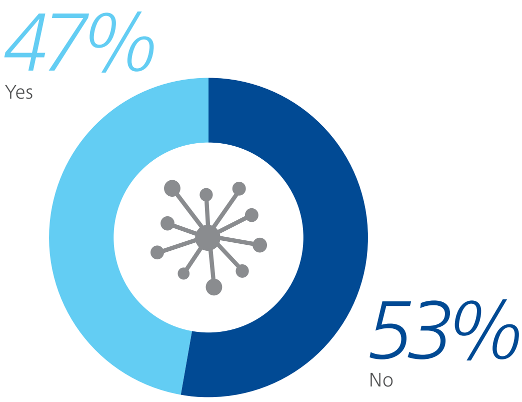


On average, managers work with 39 different service providers to run their business. RE is an inherently local business and as such it requires local expertise, mostly at property level. For this reason, property managers, accounting and corporate service providers and lawyers account for 25 out of 39 providers on average. Conversely, there is more concentration at fund level, mainly because it is easier and simpler to rely on a smaller number of partners with whom managers can build stronger relationships to run operations more effectively.

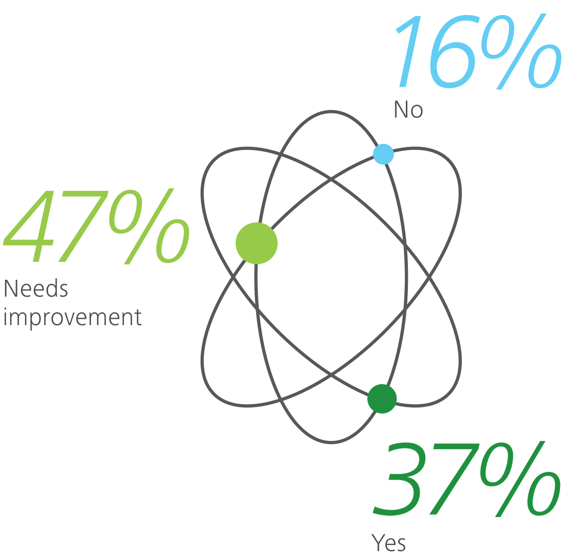
44 percent of respondents do not expect to make significant changes to their use of external service providers, 33 percent and 28 percent will increase their use of current or new service providers respectively, while only 11 percent predict a decrease. The increase in the use of service providers is driven either by outsourcing decisions, which are more complex and require material investments, or by new fund launches and investments made by managers who have already outsourced some (or all) of their activities.

SYSTEM SATISFACTION

Plan to change or upgrade system in the next 12-24 months



Satisfaction with current RE system



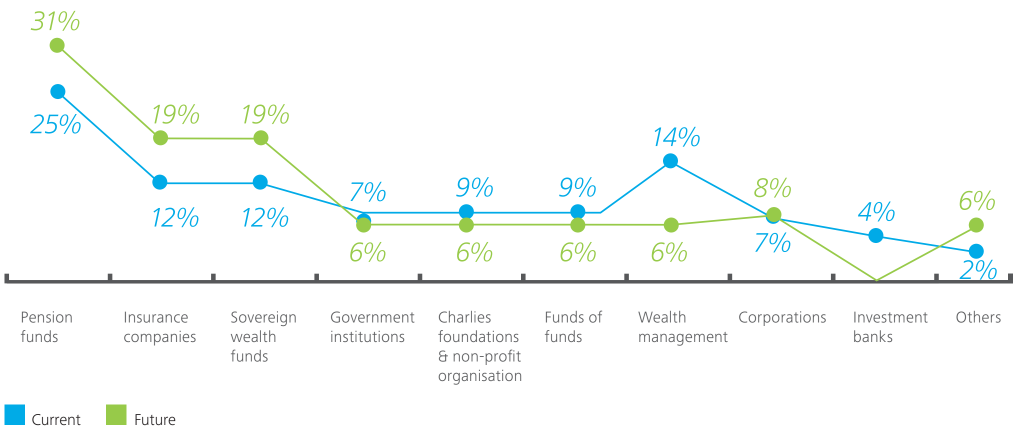
The industry is at a turning point in terms of technology: managers are moving to more sophisticated tools to answer investors' needs

When it comes to IT and automation, RE shows a delay compared to other industries: 56 percent of investment managers do not use a specific consolidation tool and only 37 percent are happy with their RE system, while for 47 percent it requires improvements (of whom 75 percent are planning to change or upgrade, while all of those who are not happy will change or upgrade their RE systems).

Growth and outlook

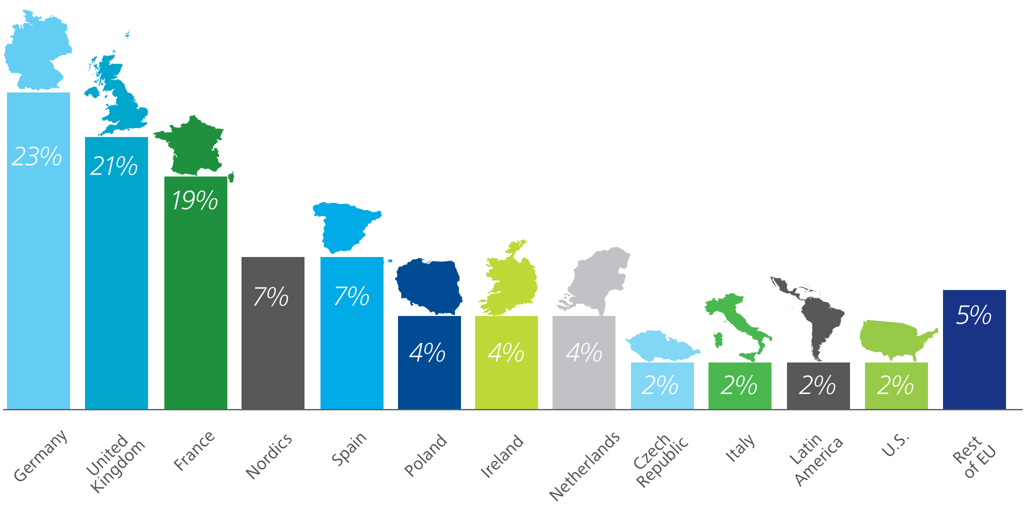
FUTURE ALLOCATION OF INVESTORS

Allocation to real estate is expected to grow across Europe mainly from capital in flows from pension funds, insurance companies and sovereign wealth funds. This is in line with INREV Capital Raising Survey 2015 stating that pension funds is the investor group that has higher allocations to RE followed by the insurance industry and sovereign wealth funds.



FUTURE ALLOCATION OF ASSETS: TARGET COUNTRIES AND INVESTMENTS

Germany, France and the UK dominate the scene as target countries according to the preferences of 63 percent of managers. Global real estate analysts believe that ultra-high net worth investors are increasingly interested in cities such as Berlin and Munich.
In terms of types of properties, managers expect to either keep or increase their current allocations to all classes but offices, which is the only type seeing a decrease in allocation for one fourth of the respondents.
Industrial/logistic and retail investments, however, are the types of properties attracting the most attention among managers, with 42 percent of respondents aiming at increasing their current allocations.



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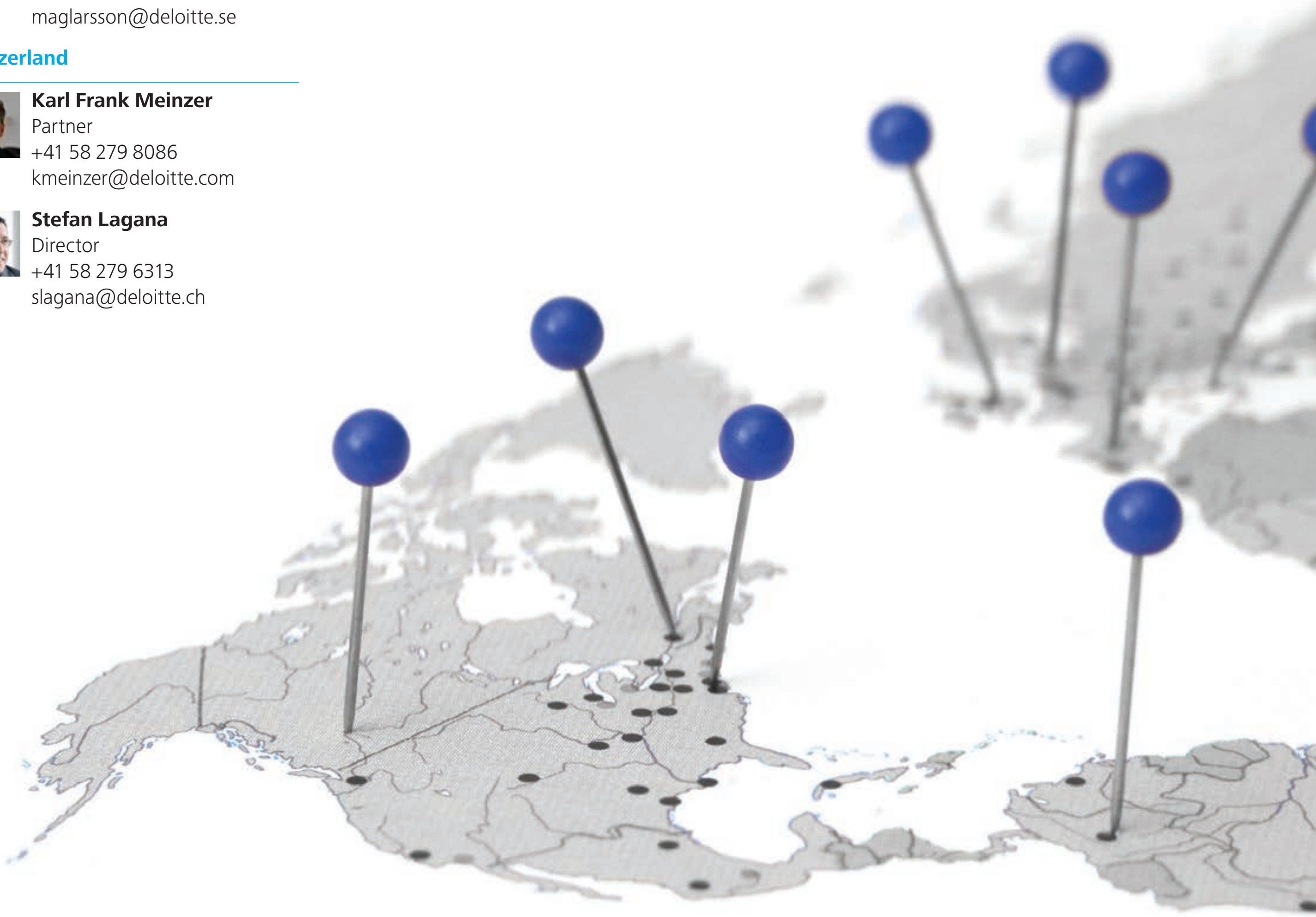

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