Deloitte 2014 European real estate investment management survey among asset managers and servicers

Forecast? Mostly sunny, with scattered clouds

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Changes in technology, taxation, or the market segment, and particularly regulatory developments, are forces keeping the real estate market in constant transformation. While this leads to new opportunities, it also creates road blocks for real estate players. leading to new opportunities, but also stop blocks for real estate players. Both real estate asset managers and asset servicers need to face these changes and adapt their business models accordingly.

What are the key priorities of their business today? How do they prepare their business for future growth and development? How do they deal with regulatory requirements? Deloitte sought answers and took the current temperature of pan-European asset managers and asset servicers in two distinct surveys recently conducted among major players of the industry.

Survey setup at a glance

Asset managers survey	Asset servicers survey
Survey period: December 2014–February 2015	**Survey period:** December 2014–February 2015
Participants: 20	**Participants:** 20
Aggregate net assets under management of participants: €200 billion, of which €116 billion are represented by Property Funds and €36 billion by segregated mandates	**Aggregate assets under administration of participants:** €197 billion under administration **Aggregate assets under depository:** €107 billion
Countries of operation: RE investment managers have established their operations in the United Kingdom, Germany (90 percent), France and Luxembourg (84 percent). Beside these four countries, the Nordic countries, including Denmark, Finland and Norway, are among the top 10 European countries where RE investment managers have setup operations.	**Countries in scope are:** Luxembourg, Ireland, Channel Islands, the United Kingdom, Germany, France, and The Netherlands Respondents have operations in at least three of the above listed countries, with 86 percent of them being present in Luxembourg and 50 percent in the Channel Islands and Ireland.

Asset managers survey—key results

Easy access to capital with positive outlook for coming months

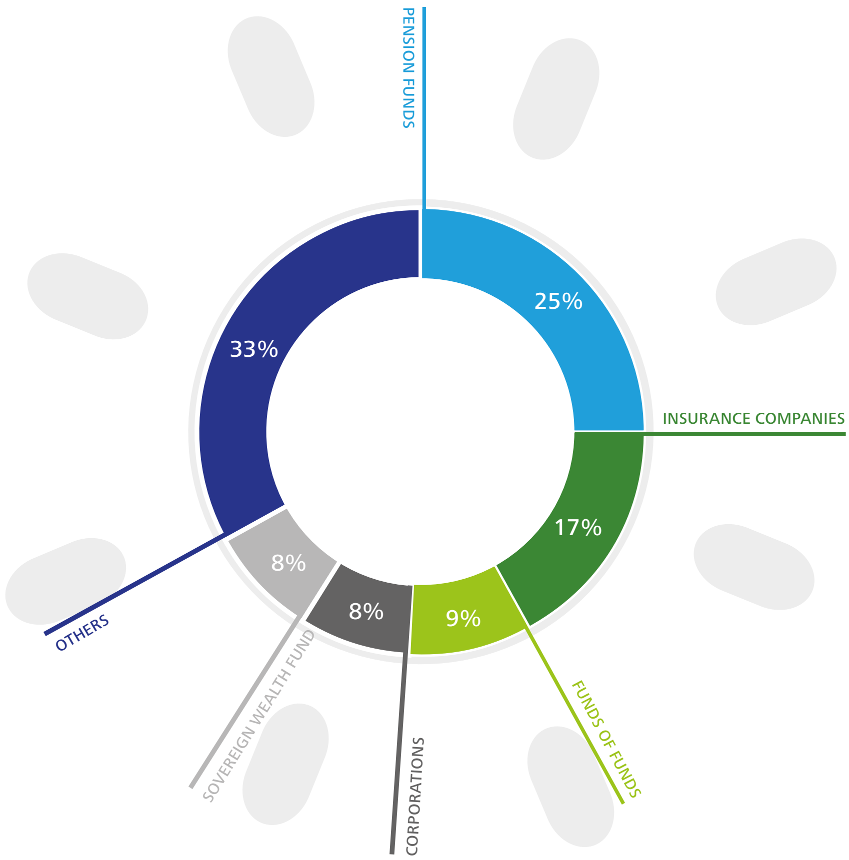
Access to capital does not seem to be difficult for real estate asset managers today and is expected to remain easy over the next two years, as confirmed by 50 percent of the respondents. Moreover, 66 percent of participants rating the access to capital in a neutral way today believe that it will become easier in the coming years.

Investors increased capital allocation to real estate but raised their level of requirements

Not surprisingly, pension funds are the main business feeders of the real estate industry (25 percent), followed by insurance companies (17 percent) and funds of funds (9 percent). In recent years, investors have increased their capital allocation to real estate, while at the same time increasing their requirements: IRR, management fee rate, and risk exposure are the most common requirements during the fundraising phase, whereas the size of the fund and length of the process have a very significant or significant impact, according to the vast majority of the respondents (74 percent and 79 percent respectively).

Specific or ad hoc reporting is the market standard: 89 percent of managers indicated that they receive a multitude of reporting requests from their investors; 53 percent of respondents provide INREV figures in addition to regulatory requirements. Overall, performances (94 percent), transparency (78 percent), and fees (44 percent) are the three key requirements for investors when assessing the managers they work with.

Figure 1: Main business feeders

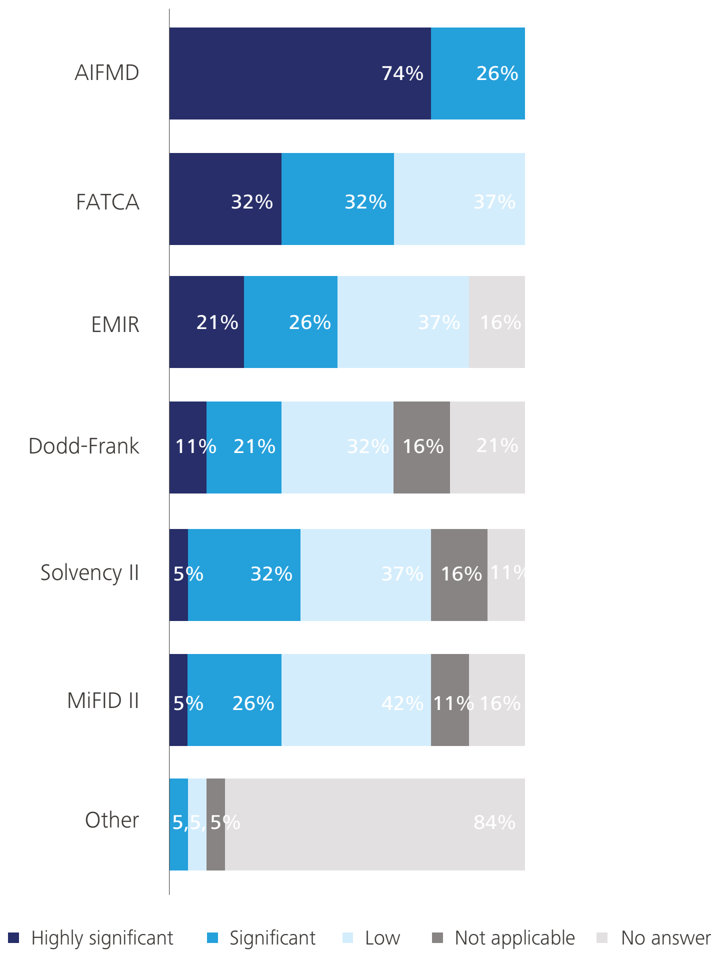


Regulation: AIFMD remains a key regulatory concern

Investors' aim for transparency goes along with the transparency imposed on managers by recent regulations: AIFMD, FATCA, and EMIR are the main regulatory concerns managers are currently facing. Among those, AIFMD is perceived as the regulation that most shapes the industry's landscape; respondents confirmed it had either very significant (74 percent) or significant (26 percent) impact. Not surprisingly, 72 percent of respondents stated that they need to review their operating model. Half of the participants confirmed that they had to increase their capital to comply with the Directive. The implementation of AIFMD is still ongoing. Reporting (74 percent), risk management (69 percent), and depositary (63 percent) have been identified to be the most challenging of all AIFMD requirements. For most of the respondents, these activities aim at the European passport (84 percent); however, for some managers, they are also driven by investor requirements and commercial reputation (68 percent and 58 percent, respectively).

In recent years, investors have increased their capital allocation to real estate, while at the same time increasing their requirements

Figure 2: Impact of regulatory changes on the organization

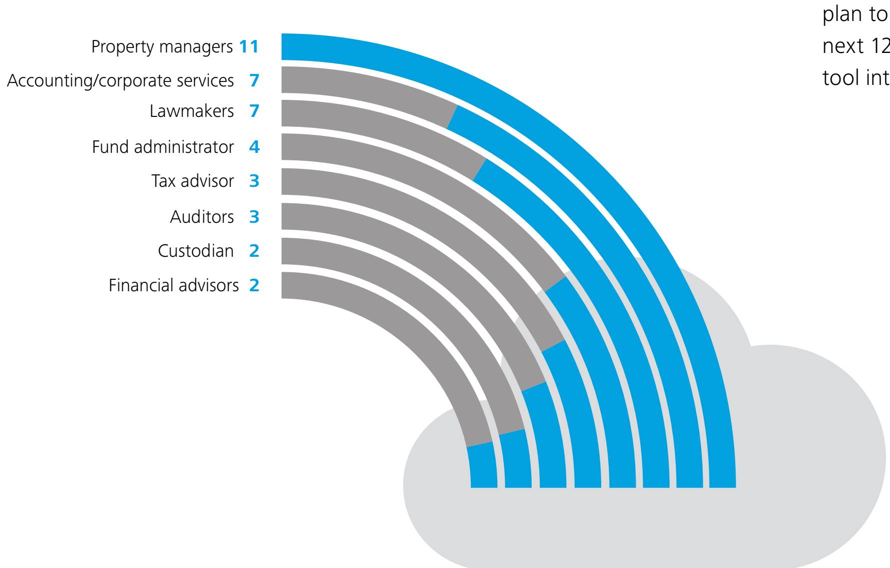


Capitalizing the investment of AIFMD and simplifications are priorities

With AIFMD being one of the factors leading real estate asset managers to review their operating model, 17 percent of survey respondents confirmed the need for operational improvements.

However, when being asked about their operational priorities for the next two years, simplification is on top of the agenda, alongside the improvement of efficiency and the increase in size of middle and back office functions to comply with regulatory requirements. The majority aims to turn AIFMD into a business opportunity rather than considering it as only a regulatory obligation, for instance, by increasing the number of mandates a single AIFM will manage or by developing a leaner structure via consolidating group entities.

Figure 3: Average number of service providers used



The operational complexity real estate managers are facing is, first of all, driven by the large number of service providers involved in the fund administration (39 on average). More than 60 percent of respondents believe the number of service providers will even increase further.

The number of external parties involved is especially high at the level of property managers, accounting and corporate services and lawyers, which confirms that real estate is essentially a local business that requires local expertise and knowledge. At the portfolio level, the industry is using a variety of IT systems and tools for portfolio monitoring, while at the fund level, where standardization and efficiencies are achievable, asset managers heavily rely on MS Excel for consolidation, rather than using specific softwares.

In this respect, the outcome of the survey is not very promising: only 37 percent of managers are satisfied with their current RE systems, whereas only 16 percent are not. However, almost half of the asset managers plan to have to change or upgrade their systems in the next 12-24 months, turning the search for the right tool into an operational priority in the coming months.

Tax landscape
79 percent of managers have outsourced tax matters since they require local knowledge, which is difficult to centralize in a single pan-European team. This team is often in charge of monitoring and coordinating with local advisors that play a key role in setting up structures.

Three quarters of respondents confirm that the tax regime has an influence when looking for investments, while 88 percent stated they consider fiscal neutrality as a key driver for investment decisions. Moreover, local governments raising tax pressure to feed their balances, in addition to international initiatives such as BEPS, are changing the tax scene in which real estate managers operate.

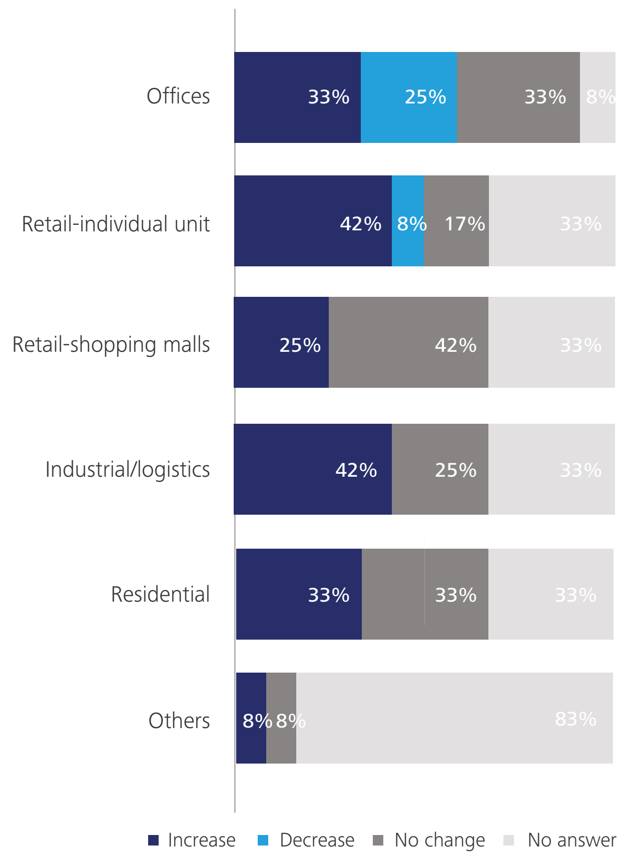
According to respondents, France (78 percent) and Germany (67 percent) appeared to be the two countries where tax authorities have increasingly challenged cross-border tax benefits, followed by Luxembourg and the United Kingdom (22 percent). To meet potential BEPS requirements, the industry seems to agree on an increase in "substance" in most holding company jurisdictions.

What is on the horizon?
Allocation to real estate is expected to grow across Europe mainly through capital flows from pension funds (+6 percent to 31 percent), insurance companies and sovereign wealth funds (both +7 percent to 19 percent), according to the survey asset managers. This seems to be in line with INREV's Capital Raising Survey 2015 confirming that pension funds have the highest allocations to real estate, followed by the insurance industry. However, wealth managers are expected to decrease their real estate allocation from 14 percent to 6 percent.

In terms of target investments, the market is split into two different classes: Germany, the United Kingdom, and France are by far the top three countries where managers plan to deploy capital, confirming a well-established trend that does not seem to change (first class).

The Nordic countries and Spain rank fourth, followed by Poland and Ireland, all with modest appreciation rates compared to the leading three (second class).

Figure 4: Allocation of assets



For real estate asset servicers, reinforcing staff and investing in technology are on top of the agenda

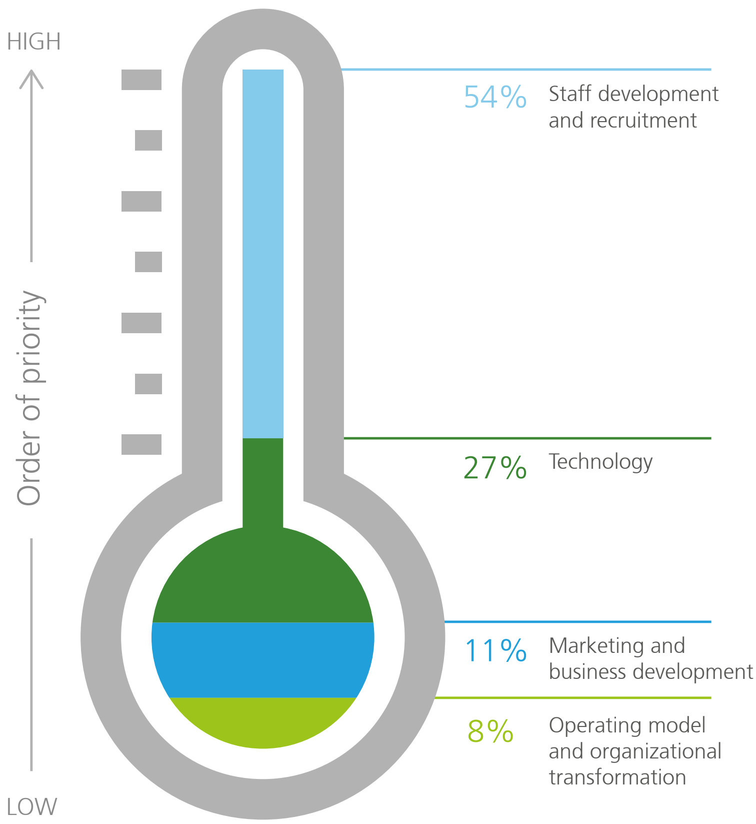
Asset servicers survey—key results

For real estate asset servicers, reinforcing staff and investing in technology are on top of the agenda, driven by a sustained and anticipated growth of the industry.

Investment in talent

Real estate asset servicers have already directed their efforts toward recruiting the right profiles as well as creating learning and development opportunities for existing staff, as confirmed by 54 percent of respondents.

Figure 5: Future investments



IT upgrades to be tackled in coming years
In contrast to asset managers, asset servicers rely on specialized software for their daily operations, with e-Front FrontInvest and Multifonds being the most commonly used IT systems (36 percent). Over 50 percent of respondents indicated that they use more than one system for their activities to respond to the variety of requirements, including investors and portfolio reporting, transaction processing, accounting and financial reporting, regulatory reporting, and cash monitoring.

While the minority of respondents is unsatisfied with its current system, the vast majority is satisfied. However, there is a great willingness to upgrade current system versions within the next 12 to 24 months, as confirmed by 75 percent of participants.

Figure 6: Systems used

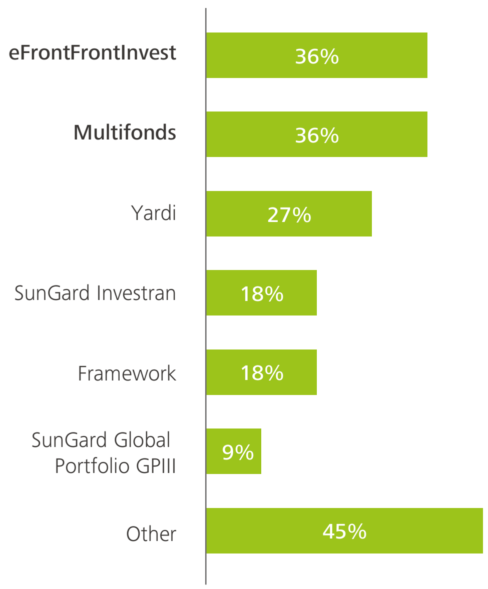
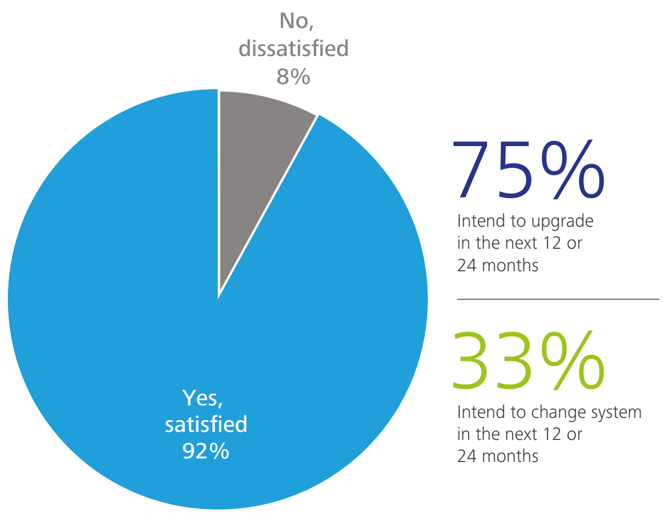


Figure 7: Level of satisfaction with RE systems used



Preparing for growth
Real estate asset servicers strongly believe that their business growth will be fuelled mainly by new clients. Extending their activities with existing clients only comes second. Value-added services are considered as growth opportunities as well as key differentiators. It is of paramount importance for asset servicers to invest in technology as well as to focus on operating models and organizational transformation to be in a position to develop and concentrate on value-added products.

Real estate asset servicers are bullish with regards to client growth, in respect of both the two-year and five-year horizon: 58 percent of respondents anticipated an increase of their client base by 11-20 percent in the next two years, whereas 42 percent forecasted their five-year growth to be in the region of 21-30 percent. These predictions are in line with the asset managers' views and the observed trends, in particular on the Luxembourg marketplace.

Figure 8: Expected sources of growth

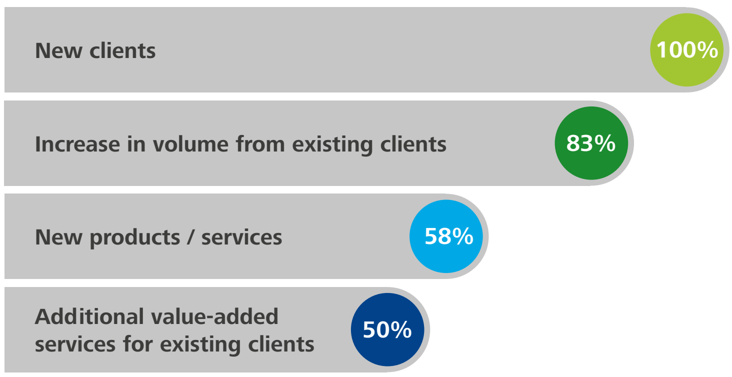
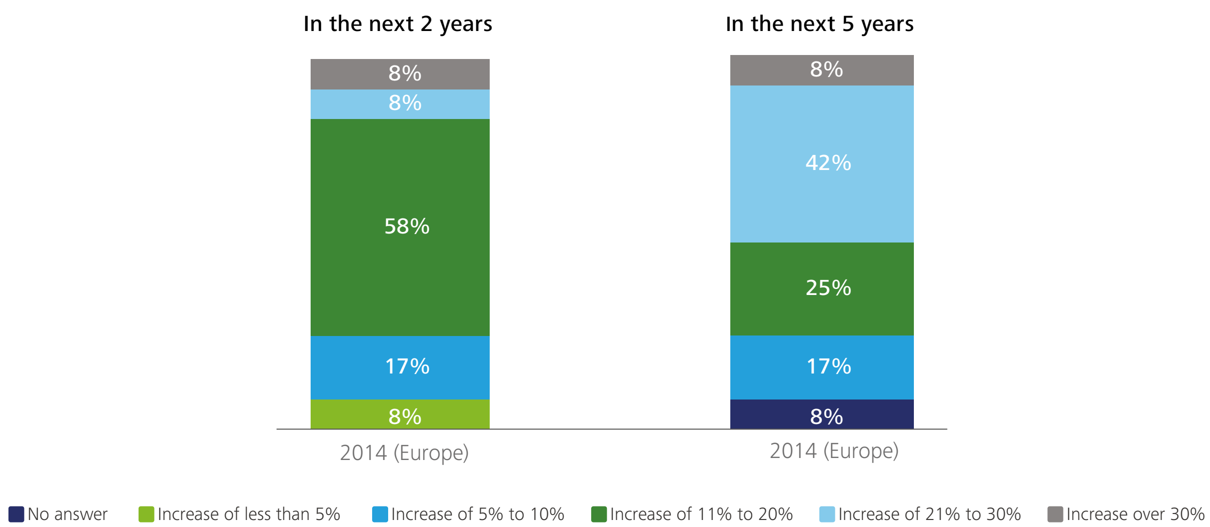


Figure 9: RE – clients' growth trends in the next 2-5 years



Conclusion: favorable winds, despite obligations

The survey shows a very positive outlook for the industry that is equally shared by asset managers and asset servicers, both of which have one common issue to tackle: the target operating model. How can we cope with new business, regulatory and investor pressure, and pan-European presence without costs being an obstacle to growth?

To the point

- Two surveys were carried out, one targeting RE asset managers established primarily in the UK, Germany, France, Luxembourg, Denmark, Finland, and Norway, and one targeting RE asset servicers established primarily in Luxembourg, Ireland, Channel Islands, UK, Germany, France and the Netherlands
- Asset managers have a positive outlook in terms of access to capital over the next coming years, their main business feeders currently being pension funds, insurance companies, and funds of funds. Nevertheless, this increase in capital allocation is partnered with an increase in requirements such as the IRR, management fee rates and risk exposure
- Despite positive outlooks for capital, the AIFMD remains a top regulatory concern for asset managers and is considered to have great impact on the organization. It is a driver to review operating models, seek simplification, improve efficiency, and increase the size of middle and back office functions in order to meet the needs of the regulatory requirements
- Asset servicers on the other hand are currently prioritizing their investments in talent and technology. In contrast with asset managers who rely predominantly on MS Excel for their consolidations, asset servicers require more specialised software for their daily operations and there is great interest for IT system upgrades over the next 12-24 months
- Conclusively, both asset managers and asset servicers are expecting increased growth rates over the next two years; asset managers expect their increase to come mainly through greater capital flows and asset servicers expect their increase to come primarily through new client acquisitions