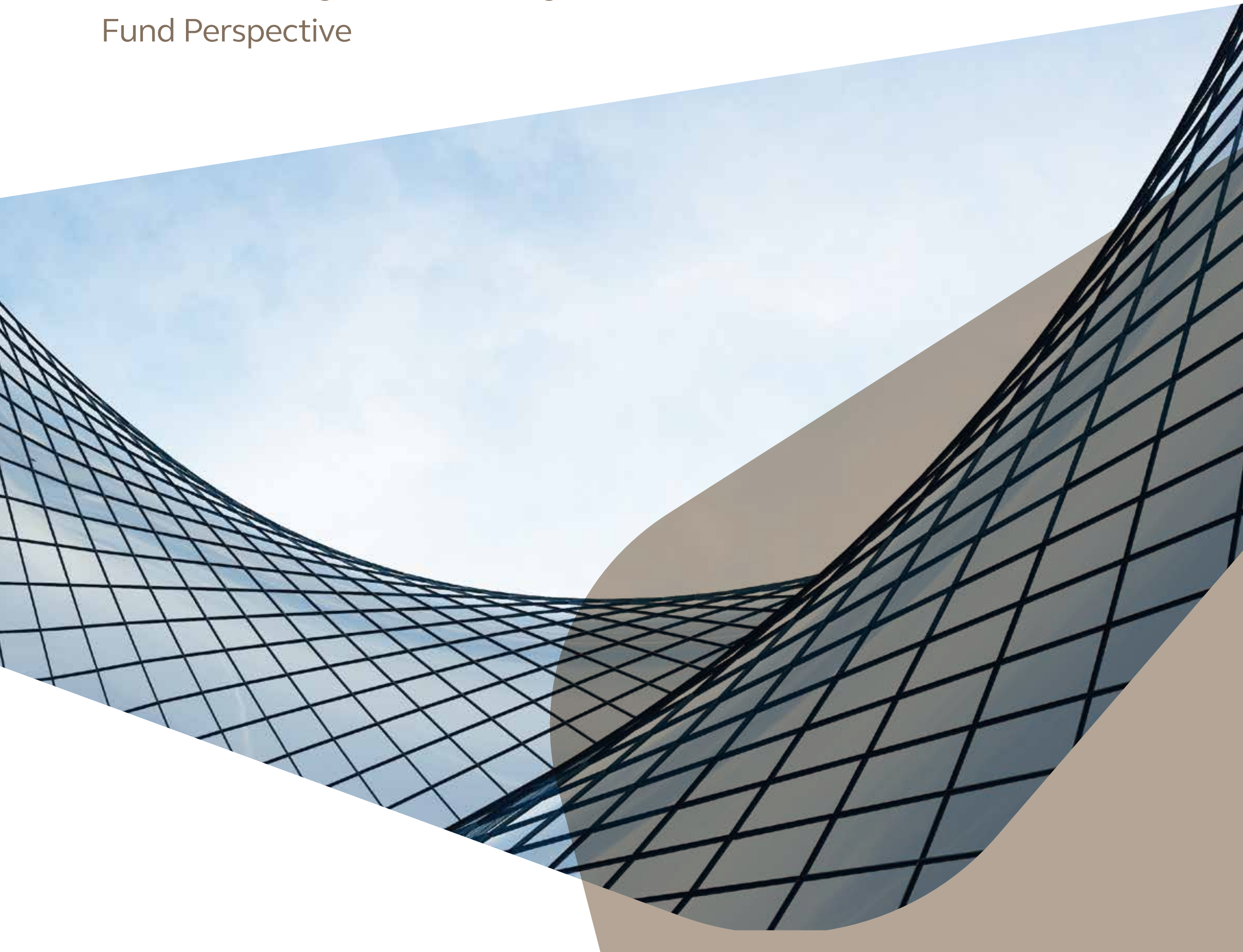
Real Estate Fund Operations Have They Reached An Inflection Point?

An Asset Manager and Sovereign Wealth Fund Perspective



Contents

Vistra and Coleman Parkes Research would like to thank the CEOs and heads of department at asset management firms and Sovereign Wealth Funds who kindly gave up their time to participate in this study. This report identifies the critical issues facing their operational models and examines how those issues may well drive change in the future.

Executive Summary

This report focuses on the global non-listed real estate (RE) industry. It is a market that has changed significantly during the last 25 years and continues to evolve. It has become democratised to the extent that it is now a sub-asset class on the radar of a much broader range of investors.

Operationally, the RE fund industry is changing quite dynamically and one of the principle drivers is post-financial crisis regulation. This is leading to greater transparency, efficiency and effectiveness. For this and for other reasons that we explore, the RE industry seems to have reached an inflection point and business models may need to change. A result of this is consolidation among firms across the industry and a close examination as to how their various operational functions are carried out.

This report focuses on four main areas as outlined below. In order to learn about these we spoke to senior executives of real estate Asset Managers (AMs) and Sovereign Wealth Funds (SWFs).

1. Factors affecting business operations

Regulation is by far the main factor impacting these businesses. Others include: changing investor appetites, especially increased interest in alternative asset classes; the development of offerings related to new geographical territories; and consolidation among industry participants.

However, while these trends emerged in the course of our research, there are geographical differences in the impacts of these factors. Also, executives with different responsibilities within their firms often hold differing opinions as to the extent of these impacts.

2. The operational model: insourcing vs outsourcing

We queried respondents on the extent to which their businesses outsourced particular functions. We found that in the majority of cases, over half of those functions were retained internally, although, in principle, it would have been possible to outsource a higher proportion.

The picture, however, was mixed across all functions and geographies. Some firms outsourced functions because of how critical they were to their business. Others kept them in-house for the same reason. Therefore, the use of outsourcing appears to be subjective to individual businesses and, moreover, is a changing picture. Functions retained today may be outsourced at a later date.

3. The outsourced model: what is driving change?

Where respondents thought it was likely that they would outsource in the future, we wanted to explore their approach to decision-making. Would they do so on a fund-by-fund basis? Would they use preferred providers for particular functions or for a number of operations? And would their outsourcing choices be made on a country-by-country basis?

The conclusion we reached was that both AMs and SWFs adopt a matrix approach to outsourcing and to their choice of providers. The matrix could include cost-saving, changes in legislation or government policy, a drive to centralised procurement within their firms and also the characteristics of their potential provider, i.e. whether it would be ‘a good fit’.

4. Technology: now and in the future

In the context of increasingly complex data requirements, often driven by compliance requirements and reporting duties, IT expenditure is important for both AMs and SWFs. Seventy-nine per cent of respondents believe that their IT spend will remain the same or increase in the next five years. They would also prefer the IT they need to be provided internally rather than outsourced for key functions such as company secretarial work and performance analysis. At the same time, they recognise that they are working in an industry that is evolving and remain agnostic as to whether or not to outsource their IT in the future.

Introduction and Background

The non-listed RE industry is still relatively young, yet it is truly worldwide in its coverage.

In 2017, global volumes for completed sales of commercial properties totalled $873bn, according to research by Real Capital Analytics. This spanned EMEA, Asia Pacific and the Americas, and continued the broad growth trend in commercial property investment that began in 2010 in the wake of the financial crisis.

At the same time, what started the present century as something of a niche sector for institutional investors is now adopted more deeply and broadly by investors, with professionalism across industry participants elevated to another level. Several representative bodies for the sector have been established and contribute to driving this professionalism. These include INREV, the European Association for Investors in Non-Listed Real Estate, which was founded in 2003, and its counterpart ANREV, which represents the Asian industry and was founded in 2007.

As the industry has developed, fund management and service provider platforms have also evolved.

As with many maturing markets, especially those that are becoming increasingly regulated, a trend towards consolidation is now substantially under way, both among managers and service providers.

Among managers, mergers and acquisitions have included Blackrock's acquisition of MGPA in 2013 and TIAA's acquisition of Henderson GI's real estate platform in 2015. More recently, Aberdeen has merged with Standard Life, Patrizia acquired Rockspring (among others), and Principal Global Investors acquired Internos.

The market among service providers has perhaps been even more active. Private equity (PE) firms have acquired and consolidated businesses in buy-and-build plays. Examples of PE consolidation include CVC's acquisition of TMF, Permira's investment in Alter Domus in 2017, and Baring Private Equity's acquisition and merger of Vistra and Orangefield in 2016.

Meanwhile, specialist alternative asset servicing firms have sought to expand and extend their range of services through acquisition. Notable among these are MUFG's acquisition of Capital Analytics and UBS's administration business, Link Group's acquisition of Capita Asset Services' business, and SS&C's pending acquisition of Intralinks.

This consolidation trend, underpinned by persistently growing capital inflows from institutional investors, is evidence that the non-listed RE industry is evolving quickly.

The drive for efficiency and cost-effectiveness

This evolution in the non-listed RE space has also been characterised by a drive for greater efficiency and cost-effectiveness, a trend that has seen a move to more integrated operating models by both managers and service providers. Vistra has observed four recent and noteworthy patterns:

- An increase in managers seeking to consolidate operations with fewer outsourcing partners;
- An increase in instances of team lift-outs from fund managers to service providers;
- An increased tendency for managers to use dedicated procurement functions to appoint and co-ordinate service providers; and
- An expansion in the range of services outsourced by fund managers.

One of the chief drivers for these developments has been regulation and the requirement for managers and service providers to achieve increasingly rigorous levels of compliance. This pressure had its origin at the highest political level following the financial crisis. The 2008 *Review of the Regulatory Issues Relating to Real Estate Funds* carried out by the Technical Committee of the International Organization of Securities Commissions (IOSCO) set out the matters that it regarded as concerning. This has been transposed into legislation over the intervening decade, along with regulation of the broad sweep of most financial markets.

RE has been touched by successive waves of regulation, including: the Basel capital adequacy regulation of the banking sector; the Solvency measures governing insurance companies; the EU's Alternative Investment Fund Managers Directive (AIFMD), in particular; and, most recently, the Markets in Financial Instruments Directive II (MiFID II).

The combined effect of these has led regulation to be the foremost concern for both RE fund managers and service providers.

The upshot has been that investors now demand higher levels of transparency and disclosure in order to monitor their RE investments more closely. Thus, RE investment services administration has become more sophisticated and has embraced higher levels of technology to meet regulatory compliance and client needs.

In light of all these developments, Vistra commissioned a study from Coleman Parkes Research to closely examine four specific areas of the RE investment universe:

1. The factors that affect the business operations of RE Asset Managers and Sovereign Wealth Funds and other government entities;
2. The operational models chosen by AMs and SWFs – insourcing versus outsourcing;
3. Outsourced models – how they operate today and how they may operate in the future; and
4. RE asset management technology now and in the future.

The results of this research and our conclusions are contained in the following sections of this report.

Research methodology

The research was conducted by telephone interviews in the period May-June 2018, among 150 senior managers.

100 respondents (66%) worked for asset management firms and 50 (33%) for Sovereign Wealth Funds or other government entities.

In terms of individual roles, 65 respondents (43%) were Heads of Fund Finance, 63 (42%) were Heads of Fund Operations, eight (5%) each were Heads of Asset Management and Heads of Investments, and six (4%) were CEOs of Fund Managers.

Respondents by location

America

27%
40 respondents

Europe

27%
40 respondents

Asia

24%
36 respondents

Global firms

22%
33 respondents

Factors Affecting Business Operations

Regulation, regulation, regulation

Though it is by no means the only major factor having an impact on our respondents' businesses, **regulation** is the clear leader.

Our questioning was aimed at establishing what main developments were currently having the biggest impact on their businesses. We offered six options – apart from regulation they were:

- Increased investor appetite across a variety of products;
- Increased activity in alternative asset types;
- Investment in new geographical territories;
- Consolidation among industry participants; and
- Change within the traditional RE sub-asset types of industrial, commercial and retail.

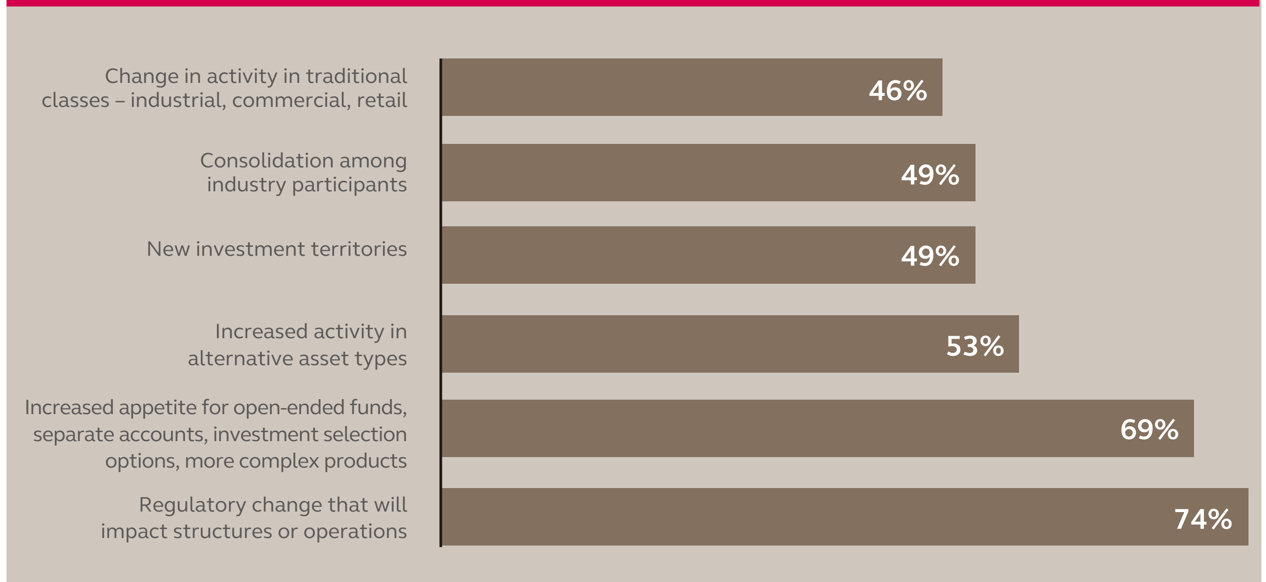
On average, across all regions, organisation types and job roles, nearly three-quarters of respondents (74%) saw regulatory change impacting structures or operations of their activities. Nowhere was this more so than among those drawn from global businesses, 88% of whom saw this as the top influencer. Given that global businesses may have to adjust to regulatory change in multiple jurisdictions, it is understandable that they feel its impact most keenly.

Of the two types of organisation surveyed, AMs were marginally more concerned by regulation than SWFs. But when it came to job roles, the differences between respondents' views were more pronounced – 100% of CEOs placed regulation as a major development, as did 88% of Heads of Investments.

Given the successive waves of regulation to break over fund management of all types, including RE funds, this focus on regulation is quite understandable.

AIFMD places property investments clearly within its sights, for example. Here, the requirement for greater transparency among alternative funds in general and restrictions on marketing to EU investors have led to greater compliance costs. In some cases, the need to gain approvals in various EU jurisdictions or to obtain an EU-wide passport have placed additional structural issues and workload at the doors of RE funds under management.

The main developments impacting fund operations



Generally, with all forms of regulation and the attached compliance burden comes cost of staff, potential restrictions on business, and higher technology costs. All of these can have significant impacts, especially on smaller firms; can be factors that force changes to business models; and may lead to consolidation to achieve economies of scale. No wonder, then, that 100% of CEOs chose this as a major factor affecting the operations of their business.

Changing investor appetites

The second most influential current development across the regions was 'increased appetite for open-ended funds, separate accounts, investment selection options and/or more complex products'. On average, 69% of respondents chose this. Notably, the figure for global firms was higher at 82% – perhaps because they may need to provide a wide variety of offerings to meet differing investor appetites across numerous jurisdictions.

Also noteworthy is that only a third of CEOs felt this was an important factor, whereas 75% of Heads of Investments and 75% of Heads of Asset Management put this in second place.

It would not, however, be surprising if those whose jobs placed them in closest proximity to clients would feel most sensitive to changes in product appetites.

Reading between the lines

All six of the issues that we highlighted were viewed as developments that were having an impact on fund operations to a greater or lesser degree, but there were some outlier results that we think may be significant.

- Only 36% of global respondents thought new investment territories would play an important role in their business. Perhaps they are already sufficiently well spread geographically, or maybe their experience leads them to believe that going into new territories will not influence their operations that much.
- Conversely, 61% of Asia-based businesses chose this as important (against 49% across all respondents). This may be indicative of a rapid growth and spread of RE funds across the Asian theatre.
- Interestingly, a mere 17% of CEOs selected new territories as a main development. What does stand out, however, is that 100% of them thought that consolidation among industry participants was important (against 49% of all respondents). Given a CEO's enterprise-wide overview, they may have a unique perspective on this trend. Sixty-two per cent of Heads of Investments agreed with the CEOs, whereas only 38% of Heads of Asset Management held this view. So these findings may have more to do with their job roles than revealing an industry-wide truth.

100% of CEOs surveyed named regulation as a major development having an impact on their operations.

The Operational Model: Insourcing vs Outsourcing

A mixed picture

Against the background of the main factors that are currently affecting their businesses, as highlighted in the previous section, we asked AMs and SWFs to what extent they outsourced their main functions or retained them internally.

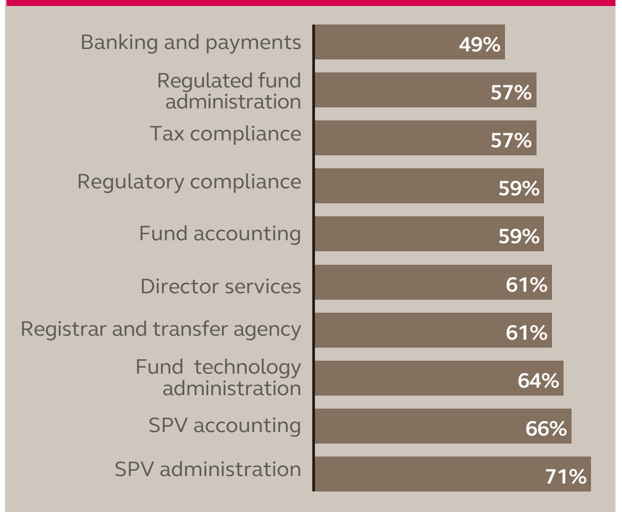
As illustrated in the chart below, we discovered that in the vast majority of cases, over half were retained internally. The exceptions were regulatory compliance and regulated fund administration in American firms (both at 48%), fund accounting in Asia (47%), fund technology administration among global firms (39%), and banking and payments for firms based in America and Asia (40% and 44% respectively). The latter resulted in the average for banking and payments standing at 49%.

High numbers of businesses across all regions retained some functions, such as SPV administration (71%), SPV accounting (66%) and fund technology administration (64%).

Despite the preference for performing functions internally, a high proportion were still outsourced, with banking and payments, regulatory compliance and tax compliance leading the field.

Given the specialised nature of such functions, many firms could be expected to source these skills or capabilities elsewhere in order to supplement their own.

Functions performed internally



Unsurprisingly then, our research revealed that two-thirds of firms outsourced the same functions across all of their funds. One might query further why all firms wouldn't do likewise, but that was beyond the scope of our questioning.

Cost control

At the same time, we were curious as to the drivers behind why certain functions were retained in-house while others were outsourced.

With regard to internal retention, we learned that the three principal reasons were **cost control** (66%), the **criticality of the activity** to their businesses (62%) and **concern around the ownership and/or control of data** (53%).

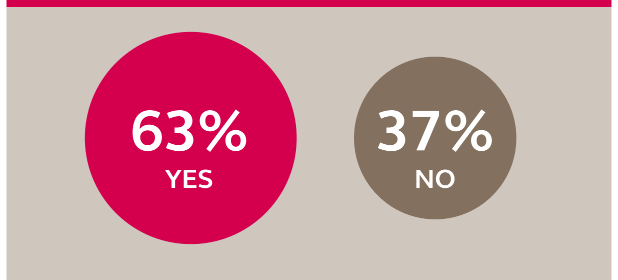
Conversely, and perhaps unsurprisingly, compliance with regulations, as highlighted above, was the key reason a function was outsourced (65%).

Puzzling, however, is the apparent anomaly that one of the top three reasons for outsourcing was also the criticality of activities. This particular point seems to slice both ways.

While there was some variation across the regions, our findings were pretty consistent. There were, however, some differences depending on whether a respondent's organisations was an AM or SWF. For example, 70% of AMs were most concerned about cost control, compared with 58% of SWFs. At the same time, 64% of SWFs said they retained functions internally because they had sufficient internal expertise, but this figure fell to 44% for AMs.

To explain these differences, one could conclude that AMs, working in a perhaps more competitive market, were more sensitive to cost and were less inclined to hire expert staff. SWFs may not be as cost-conscious and/or may feel that, in line with their public responsibilities as tools of their states, it is beholden upon them to hire staff and ensure that the performance of their duties trumps mere cost considerations.

Functions outsourced across all funds



Different views from different desks

When it came to examining the research data by job function, some additional inconsistencies emerged. For example, three-quarters of Heads of Investments said that cost control was a reason why functions were retained in-house, compared with 33% of CEOs of Fund Managers. In another case, 100% of CEOs said it was because resources were available internally but only 25% of Heads of Investments held this view.

On the outsourcing question, all of the Heads of Asset Management held that the principal reason for outsourcing was to ensure compliance with regulations. Only 62% of Heads of Fund Finance apparently agreed with them, and only half of CEOs. Perhaps these anomalies say more about the difference of views among a firm's executives rather than anything else.

A changing model?

So, if this is the state of play in the internal-versus-outsourcing models in today's market, how might this look in the longer term, say five years hence? Will outsourcing increase, decrease or stay the same? The answer to this question tends in one direction, but isn't wholly conclusive, especially in the context of the continual increase in regulation and compliance that can distract staff from their day jobs of managing money.

In fact, 47% of respondents said that they foresaw an increase in the functions outsourced and a 51% increase in the volume of activity outsourced – 39% and 36% respectively thought there would be no change, and 14% and 13% respectively that there would be a reduction in outsourcing. Overall, then, respondents predict an increase in functional outsourcing.

On average, those who thought that outsourcing would increase, believe it would do so by just under 15%.

One of the answers that intrigued us the most was around the perceived cost of outsourcing. While 39% of respondents thought that outsourcing was more expensive than performing a function in-house, interestingly 28% thought outsourcing was less expensive, with 33% saying that it was cost-neutral.

It is worth considering, however, that given the industry-wide consolidation that is taking place, it may be that when organisations combine, there are gains in the skills available to the business as a whole. Perhaps the need or the preference to outsource can reduce as a result.

In practical terms, there can, of course, be an opposite effect. Should the firms involved in a merger or acquisition lack particular skills, the need to outsource could become even more pressing now that the enterprise as a whole has enlarged. However, an increase in headcount to cover an outsourced function may also be more justifiable.

Anticipated change in functions outsourced in five years' time

Whilst 39% of respondents thought that outsourcing was more expensive than performing a function in-house, 28% thought it was less expensive, with 33% saying that it was cost-neutral.

The Outsourced Model: What is Driving Change?

Fund-by-fund selection preferred

On the basis that respondents thought that outsourcing was likely to increase in the foreseeable future, we wanted to examine the decision-making process. Exactly how is the decision to outsource made, and what factors are taken into account?

First, we tested our respondents' current approach, to establish which outsourcing provider selection model they use. The options that we offered were:

- Fund-by-fund selection;
- Preferred provider(s) – functional selection;
- Preferred provider(s) for all operations;
- Split fund and SPV administrators; and
- Country-by-country selection.

While many respondents used multiple models, fund-by-fund selection came out on top overall for both SWFs (74%) and AMs (68%). Preferred providers by functional selection came second with both SWFs and AMs at 64%, while preferred providers for all operations was in third place with 64% and 60% respectively.

The consistency of these views was largely even across all regions and job roles.

Cost saving leads a range of factors

Having established which outsourcing model our respondents currently use, the next question delved deeper into the factors which led to that decision.

We asked respondents to rank their top three choices across a broad range of factors.

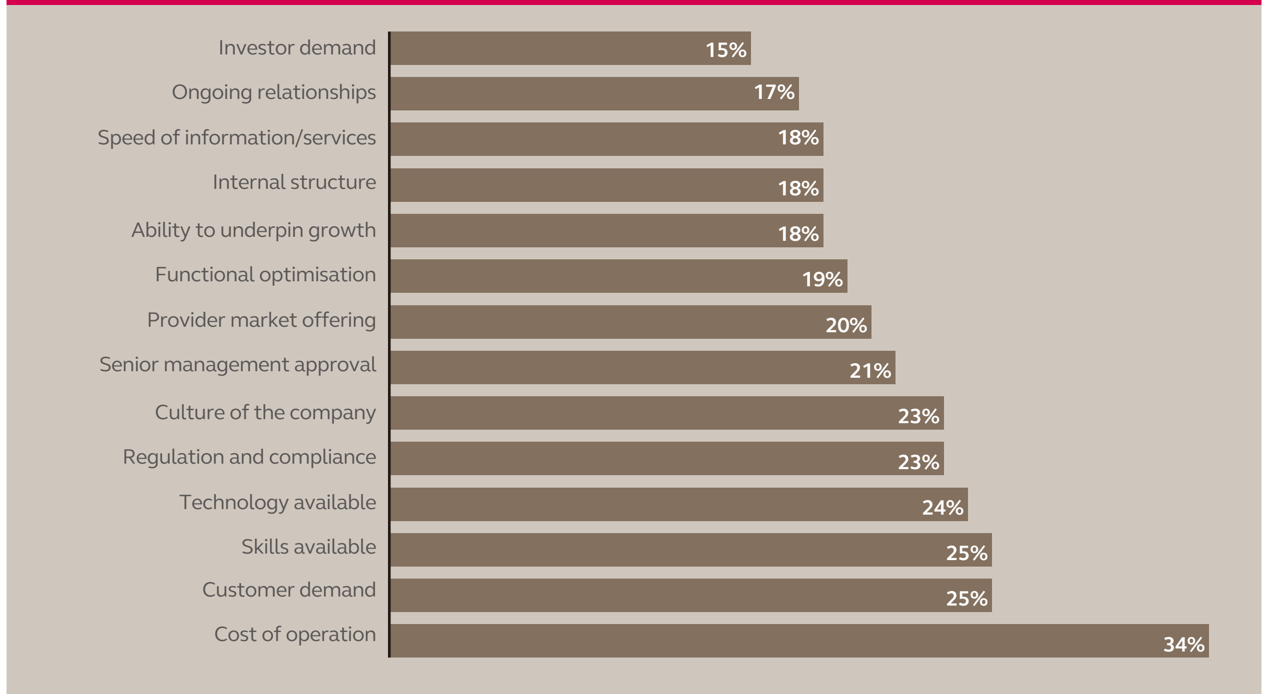
On average, 'cost of operation' was the highest-ranked factor – selected by 34% of respondents. 'Customer demand' and 'skills available' followed, both attracting votes from 25% of respondents.

As our graphic (right) shows, the responses to this question were spread widely across the options presented and even the least popular, 'investor demand', scored 15%.

This seems to demonstrate how AMs and SWFs refer to a wide variety of options, and their choice of outsourcing model is broadly based rather than being reliant on a few major criteria. There are, however, some regional variations.

Outsourcing provider model used

Key factors determining outsourcing model



Americans save cost

For respondents in the America region, cost is by far the most important factor – 45% of them placed it in top spot. Yet only 18% of global respondents did so.

At the same time, 36% of global firms highlighted 'provider market offering' as a priority, but the individual regions attached less importance to it – America 10%, Europe 15% and Asia 22%.

In another example, 'speed of information' received the vote from only 6% of Asian respondents, whereas 33% of global firms attached importance to it.

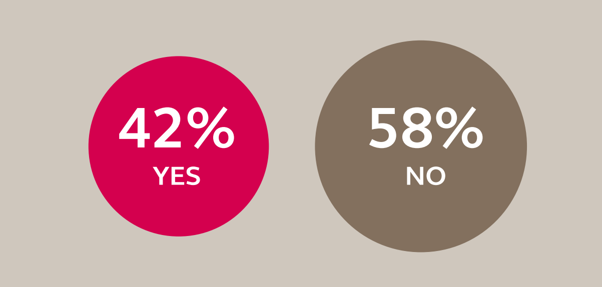
Going on to look at the response by job title, there were some disparities as well – 67% of CEOs chose 'skills available', but only 12% of Heads of Asset Management did so. Yet 'culture of the company' mattered to 50% of Heads of Asset Management, but didn't register with CEOs at all.

Majority favour no change to their outsourcing model

Having established the factors that fed into the decision-making process, we then enquired as to whether firms were actually considering changing their current outsourcing model. A majority, 58%, said they were not, while the remaining 42% said they were.

> Asset Managers and Sovereign Wealth Funds refer to a wide variety of options, and their choice of outsourcing model is broadly based rather than being reliant on a few major criteria.

Businesses looking to change outsourcing model



American firms (65%) and global businesses (64%) are most convinced that they won't change their model. Asian and European firms are less so – 50% and 54% respectively.

Examining responses by organisation type revealed that a slim majority (52%) of SWFs are looking to choose a different outsourcing model. Asset Managers seem much more convinced that they've got it right at present – 63% of those voted for no change.

Slicing the same data into job roles was also revealing – 100% of CEOs of Fund Managers said that they were not looking to change their model and 65% of Heads of Fund Finance agreed with them. However, three-quarters of Heads of Asset Management were looking to change. This, at the very least, will make for some lively internal debates around the subject.

Legislation and government policy are leading drivers

We went on to query what main factors could bring about a change to firms' current outsourcing models. The results were quite evenly spread over a number of options, such as internal reorganisation, consolidation of service providers and fund launch pipeline.

One factor, however – change in legislation or change in government policy – was marked out by 67% of respondents as a potentially significant influencer.

This is entirely consistent in the context of the continual imposition of regulation, and with our research, featured earlier, which found that 74% of respondents saw regulatory change having an impact on structures or operations of their activities.

Centralised procurement

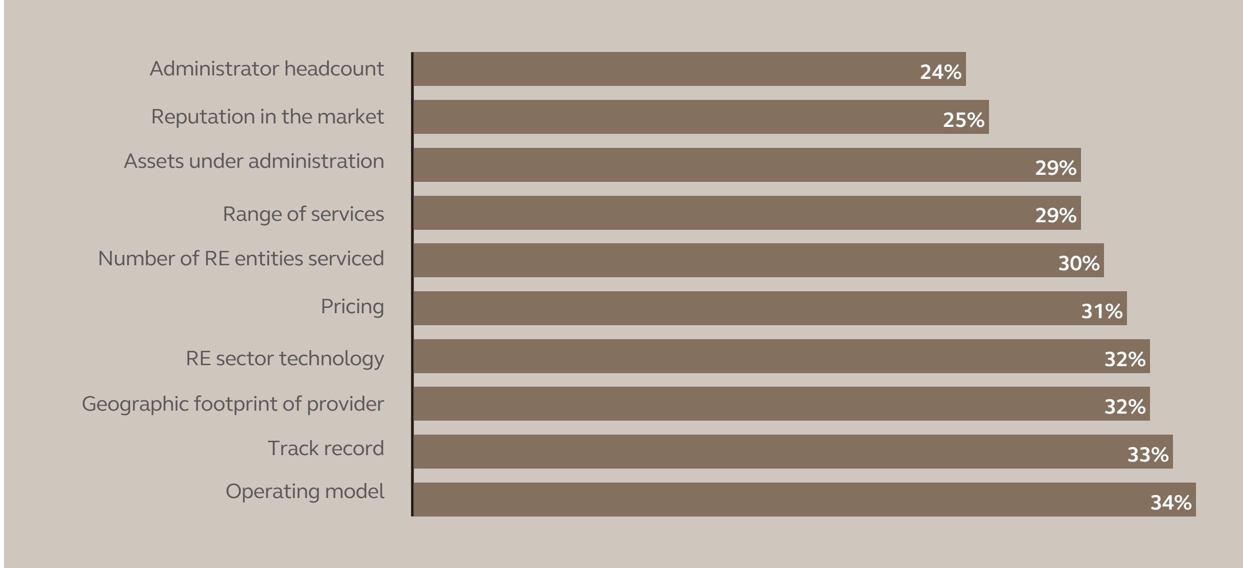
How, then, do firms manage their procurement of outsourcing services? On average, in 58% of firms, procurement is a centralised function. Otherwise teams select different elements in procuring services. Refining these results by region, however, almost three-quarters (73%) of European firms surveyed centralised their procurement, whereas only 42% of those in Asia did so.

Assessing service providers

We then questioned how AMs and SWFs assess their potential service providers. We offered 10 choices and, on average, the provider's operating model ranked highest, chosen by over a third of respondents.

> 100% of CEOs of Fund Managers said that they were not looking to change their outsourcing model, yet 75% of Heads of Asset Management said they were looking to change. Which is likely to spark lively internal debate.

Top considerations when assessing service providers



On wider examination, however, the research points to the conclusion that many of the factors are of equal or near-equal concern, with all falling within a bracket of 24% to 34%.

There are, however, some regional differences among firms.

Global firms are largely unconcerned about the outsourcing partner's operating model (15%) compared with other regions. Nor do they appear to care about administrator headcount (15%). What global firms do regard as important are track record (48%) and reputation in the market (39%).

American firms were most concerned with RE sector technology, a provider's geographic footprint and the number of RE entities serviced.

Asian firms attached most importance to operating model, with many of the other criteria given equal or similar weight. European firms chose range of services, operating model and pricing as their most important criteria.

There were also some differences between AMs and SWFs. Thirty-nine per cent of AMs ranked operating model highly, compared with only 24% of SWF respondents. Track record was chosen by 37% of AMs but only 26% of SWFs. However, the number of RE entities serviced was much more important for SWFs, at 40%, against 25% of AMs.

The final question we put to respondents concerning the choice of outsourcing provider was to what extent independent certifications were an important criterion. We found that these were important to 92% of respondents across all regions, to AMs and SWFs, and across all job functions.

In summary…

All in all, our research shows that AMs and SWFs take a matrix approach to outsourcing providers. They take a number of internal factors into account that depend upon the nature and existing capabilities of their own organisation. On the whole they are content with the arrangements they already have for outsourcing, but a number of factors could change their existing model.

If their models were to change, then they would assess potential outsourcing counterparties using a balance of criteria and measures. There would be no single overriding measure that would sway any outsourcing decision they might make.

More and More IT

The complexity and data demands of regulatory compliance are forcing the pace at which new and more powerful technology is being developed in the RE funds industry.

Added to this, increased competition and client requirements for transparency are heaping pressure upon AMs in particular, but also on SWFs, to improve the efficiency and effectiveness of their operations.

Faster, more powerful technology, offering increased functionality across every aspect of fund businesses is, therefore, high on firms' agendas. Moreover, the cost and logistics of acquiring such technology is so burdensome that this is a significant factor leading to consolidation in the marketplace and gaining the scale advantages that combinations can offer.

Nearly half of respondents (46%) believe that their IT spend will increase in the next five years. In fact, 61% of global firms hold that view, although only 36% of Asian ones do so.

Against the background of the succession of regulatory demands that have affected the industry, IT spend may already be running at high levels. So when, on average, a third of respondents hold the view that their IT spend may stay the same over the five-year period, we shouldn't perhaps underestimate the scale of IT cost that they envisage.

Interestingly, when looking at respondents' views on the IT question in terms of the type of organisation they work for, it emerges that 53% of AMs, but only 34% of SWFs, say that their IT spend will increase. We can speculate that the cold winds of competition and investor demand may affect AMs more keenly than SWFs and other public entities. On the same basis, 27% of AMs thought their IT spend would remain the same, though the figure for SWFs was 44%.

What we can say across all regions, organisation types and job roles is that only 21% of respondents believe that IT spend will be likely to decrease.

In the context of all financial services businesses across the world, RE funds are unlikely to be very different from other organisations. IT spend and increased speed, functionality and effectiveness amount to the Holy Grail among financial sector operational priorities.

External vs internal

Looking at key functions that are currently performed by an external administrator and those that are retained in-house, we found that fund accounting was split fairly evenly between the two – 51% versus 49% respectively.

Company secretarial work was split 54% external and 46% internal, while 55% of fund consolidation was performed by an administrator and 45% retained in-house.

The greatest variation emerged from property management and performance analysis, where there was a much more significant number in favour of utilising an administrator – 59% as against 41% carried out internally.

However, when asked whether they would **prefer** technology to be delivered internally or to be sourced from outside, the broad response was that across key functions they would prefer it to be internally provided. This seems to contradict the current models that are in place and would indicate that at some point there will be a significant transition.

> Against the background of the succession of regulatory demands that have affected the industry, IT spend may already be running at high levels.

For instance, we found that 67% of respondents prefer company secretarial work to be kept in-house, with property management at 65%, performance analysis at 57%, fund accounting at 54% and fund consolidation at 51%.

We then asked respondents if they felt that the currently available technology met their needs. We asked them to rank their responses on a scale from 'fully meets our needs' to 'does not meet our needs'. The result showed that 62% of respondents inclined towards 'fully meets our needs' to a greater or lesser degree.

This, again, seems slightly contradictory to the fact that 46% of respondents said they expected IT spend to increase in the next five years, which suggests discontent with their current IT operations.

Key technology developments

Our final question was designed to gauge what respondents thought were the most important developments in real estate fund technology.

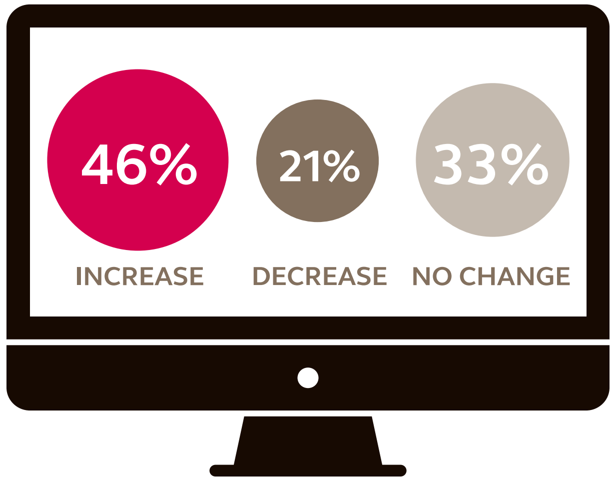
We set out a broad selection of options to choose from and the top three were:

- Improved function performance for RE fund accounting systems (42%);
- Improved portals to enhance investor experience (42%); and
- Improved data aggregation for better performance analysis (41%).

However, close behind in the list of respondents' choices were 'increased process automation', 'robotic processing developments' and 'more efficient interfaces between property management and accounting systems'.

These results were fairly consistent across regions and organisation types, but respondents in different job roles were rather more divergent.

Anticipated change to fund operation technology spend in the next five years



For example, no CEOs chose 'increased jurisdictional coverage for RE fund accounting systems', only 12% of Heads of Investments chose it, but half of all Heads of Asset Management chose it.

Similarly, only 12% of Heads of Investments cared about 'improved data aggregation for better performance analysis', though 62% of Heads of Asset Management highlighted it as an important development.

The conclusion to draw from this and other differences masked by average findings is that it depends on who you talk to.

But perhaps overall we should pay attention to averages, otherwise the findings of our research could be unreasonably skewed towards particular job functions.

> **IT spend and increased speed, functionality and effectiveness amount to the Holy Grail among financial sector operational priorities.**

Conclusion

Taking a final, broader view, we asked respondents which of five key economic factors are affecting the current real estate marketplace as a whole. The results were:

- Competition (65%);
- Complex regulation (61%);
- Transparency and disclosure standards (57%);
- Government policies (55%); and
- Lack of investors (53%).

So, it is against the background of these imponderables that we must set the conclusions of our report.

Regulation drives change

Regulation and compliance demands are the main influencers of real estate fund businesses. They have an impact on every aspect of their activities and therefore influence the business models of both AMs and SWFs.

Investor appetites changing

We conclude that there is increased appetite now among investors for open-ended funds, various types of accounts and new, perhaps more complex real estate investment products, especially where these may vary from the traditional lines of industrial, commercial and retail asset sub-classes.

In or out – the outsourcing conundrum

Although significant proportions of RE fund business functions are now outsourced, quite a high proportion are staunchly retained internally.

For example, barely half of RE funds' banking and payment operations are conducted externally, although this is unlikely to be a core business activity. Roughly two thirds of respondents told us that they tended to outsource the same functions across all of their funds, but their general preference was to perform many business functions internally rather than farm them out to specialist providers.

Cost vs expertise

This did have its limitations, however. Although a principal reason for retaining tasks internally was to contain cost, when it came to regulatory compliance and other functions involving significant specialist skills, these were, in fact, often outsourced.

It was perhaps this that gave rise to the finding that in future around half of respondents predict that there will be an increase in both the functions and volume of work that will be outsourced.

Complexity and balance in business model choice

Forty-two per cent of RE funds surveyed are contemplating a change to their current outsourcing model. But the decision to do so is complex and needs to be based on a balance of factors.

Leaving aside cost, which is the leading determinant of which outsourcing model to choose, there is a range of factors that carry broadly similar weights in the decision-making process of whether or not to employ outside providers.

Nonetheless, regulation, legislation and changes prompted by government actions appear to matter most. Considering the significant impact that regulatory measures have had across all parts and in all geographies of the financial services industry, this is quite understandable.

> Overarching every aspect of RE fund business is increased regulatory complexity. This is widely recognised to be having an impact on models and increasing the need for the development of functional expertise.

Complexity and balance in outsourcing partner choice

Similarly, in choosing external service providers there are many criteria that are taken into account. While a provider's operating model was an important measure, there were others, such as track record, geographic footprint, RE sector technology and pricing, which carried very similar weight in the selection process.

Technology at a price

Technology spend seems likely to continue to be a significant budgetary item for RE funds over the next five years – 79% of respondents told us that their tech spend would be greater than or equal to their current level. When we consider the large expenditure that organisations have been obliged to shoulder over the decade since the financial crisis, then this finding suggests the pressure to make high levels of investment will persist.

Although 62% of businesses told us that they were broadly satisfied with the technology applications that they currently use, our findings also showed that there were important developments coming down the pipe that respondents regard as important.

Whether they will invest in such technology themselves when it is available or buy in capabilities from outside providers remains to be seen, but our sense is that they are biding their time and will make their decisions on a case-by-case basis.

RE funds – the inflection point?

We conclude from our findings that the RE fund industry has reached an inflection point in its evolution, where operating models may have reached maturity.

In the past, the choice of internal versus outsourced models was determined organically and in many cases employed a mix of both approaches. Now, industry participants are trending toward much more strategic approaches to the development and management of their operating models.

Less variation in model types?

There has been functional specialisation developing on both the RE fund and external provider sides. At the same time, the rate of development of provider capacity has accelerated due to consolidation in that space.

We believe that this may trend toward less variation in model types adopted by managers and increased formality and planning in determining and implementing models.

Regulation, regulation, regulation

Overarching every aspect of RE fund business is increased regulatory complexity. This is widely recognised to be having an impact on models and increasing the need for the development of functional expertise.

This is turn has led to the realisation that there are increasing opportunities to improve the efficiency and effectiveness of operations through the use of technology that can produce, harness and handle better data quality.

Technology spend seems likely to continue to be a significant budgetary item for RE funds over the next five years.

About the authors

Vistra

Vistra Group, ranked among the top four service providers globally, is a versatile group providing a uniquely broad range of services and solutions – from fund administration to trust, fiduciary and international expansion.

As a leading global player with expert industry knowledge and location specialists, Vistra has a deep understanding of the professional worlds of our clients and a proven track record of offering highly versatile solutions, providing the people, processes and products that help our clients get the most from their international businesses.

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Coleman Parkes Research

Coleman Parkes Research, the UK-based independent leading business-to-business research company, designed and implemented the research project on behalf of Vistra.

All information was obtained under the rules of the Market Research Society, which ensures respondent anonymity and confidentiality. One hundred and fifty detailed interviews, using an agreed set of questions, were completed among Asset Managers and Sovereign Wealth Funds and other government-owned entities in America, Asia and Europe.

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