Risk Management and reporting for Real Estate
**Risk Management for Real Estate**

**Agenda**

1. Preamble - Risk Management
2. Risk Management - Regulatory environment
3. Risk Management - Best Practices
   3a. Risk Management throughout the investment cycle
   3b. Definition of Key Risk Indicators (KRI) and risk dashboards
4. Reporting
5. Service offering
Preamble - Risk Management
**Preamble**

**Risk Management**

**Risk Management: a broad concept**

- More than being a limited and defined approach; It is more about a global concept
- Risk Management is about identifying all risks to which an entity is exposed or might be exposed (which can be either financial or non-financial) and defining and implementing measures that will help to monitor, measure, manage and report these risks

**Relevant for who?**

- All entities whatever their activities whatever their investments
Risk Management
Regulatory environment
Regulatory environment
AIFMD

Context:

- The Alternative Investment Fund Manager Directive (AIFMD) entered into force on 1 July 2011

⇒ The ultimate deadline for EU Member States to transpose the AIFMD into their national law was July 2013.

⇒ Level 2 guidelines have been issued by the European commission as at 19 December 2012

⇒ Risk Management is one of the key aspects of the regulation
**Regulatory environment**

**AIFMD who’s impacted?**

ESMA - Key Concepts - A vehicle meets the definition of an AIF when **ALL** the following criteria are met:

1. **Collective Investment Undertakings**
   - Not an ordinary company with general commercial purpose
   - ‘Pooled’ capital to generate ‘pooled return’
   - No ‘day to day’ discretion or control by shareholders

2. **Raising Capital**
   - Taking step to procure transfer or commitment of capital
   - ‘Involves some kind of commercial communication’
   - Member of governing body, manager, certain employees, pre-existing group

3. **Number of Investors**
   - ‘Look through basis’ (nominee, fund of fund ..)
   - Not prevented from raising capital from more than 1 investor

4. **Defined Investment Policy**
   - Determined and fixed upfront, documented, enforceable, with investment guidelines
**Regulatory environment**

**Risk Management impacts of AIFMD/SIF Law**

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Governance

• An independent Risk Management function must be created
• Remuneration policy should be consistent with effective Risk Management
• A clear Risk Management process needs to be implemented

Risk Measurement

• Each AIF’s risk profile must be defined
• All risks associated with AIF strategies need to be measured and monitored (Market risk, Counterparty risk, Operational risk,...)
• The importance of having a strong Liquidity risk management process is particularly stressed
• Leverage levels as well as methods used need to be cleared identified and monitored

Disclosure

• To increase the transparency of the market, a high degree of importance will be put on disclosure (level of leverage, investment strategy, risk profiles,...) The level of granularity will be different whether the stakeholders are the investors or the authorities
**Regulatory environment**

**Risk Management impacts of AIFMD / SIF law**

Risk Management impact on Real Estate fund:

- In the context of Real Estate funds, Risk Management needs to be **approached in a different manner** (i.e. transfer of standard UCITS risk management framework will not work).
- All funds impacted by AIFMD/SIF law will have to describe the processes that have been put in place to identify measure, manage and monitor all the risks to which the fund is materially exposed or could be exposed considering, at the minimum:
  - *Market risk (including leverage)*
  - *Counterparty risk*
  - *Credit risk*
  - *Liquidity risk*
  - *Operational risk*

⇒ What do these Risk exposures mean in the RE industry?
Having procedures does not mean that actual processes are in place!
Best practices
How to properly structure a sound Risk Management approach

Main aspects to consider in risk approach:

1. Governance (Independence, Risk appetite, reporting lines...)
2. Risk Management throughout the investment process
3. Risk exposures at:
   • Fund level;
   • Sub-portfolio level (if any);
   • Investment level.
Risk Management throughout the investment cycle
Risk Management throughout the investment cycle

Risks must be analysed considering the investment value chain as well as the fund structure.

**Investment value chain**

- **Structuring**
  - Understand and define investor risk appetite and include it throughout the investment management process
  - Identify and maintain a reliable sourcing network
  - Identify all risk exposures related to the selected project and ensure its adequacy with portfolio management
  - Ability to gather the IC within a reasonable timeframe
  - Quality of the first valuation and short due diligence

- **Sourcing**
  - Partners selection for due diligence
  - Quantification of main risk indicators: Property risk (location, condition, sustainability, ...) income risk (tenants, cash-flows), economic and property market risks (supply and demand, macro and socio economic risks, financing, liquidity), valuation risk.

- **Pre-investment analysis**
  - Establish acceptable risk limits.
  - Measure and monitor identified risks. (property, income, financing including covenants, valuation, currency etc)
  - Conduct periodic stress tests and scenario analysis.
  - Monitor leverage ratio.
  - Management and monitor liquidity (least relevant for closed ended unleveraged funds)

- **Preliminary internal Go / No-Go**

- **Due Diligence**

- **Investment Approval**

- **Fund disbursement**

**Fund structure**

- Quality of related parties (investors, banks ...) and its evolution
- Direct investments or Fund of RE funds
- Adequacy of people profiles
- Maturity status of investments (e.g. Projects, built ...)
- Main strategy (e.g. Core, value added, opportunistic ...)
- Quality of process
- Type of investments (e.g. Offices, retail, logistics ...)

Risk Management and reporting for Real Estate
PwC
Definition of Key Risk Indicators (KRI) and risk dashboards
**Definition of Key Risk Indicators (KRI) and risk dashboards**

**Definition of a reporting framework and tool**

Use of a Key Risk Indicators database

Select your risk level, the kind of risks you want to evaluate, and Key Risk Indicators related to these type of risk.

Then, upload your selected KRIIs to a dedicated tool
**Definition of Key Risk Indicators (KRI) and risk dashboards**

**Definition of a reporting framework and tool**

**Detailed Risk assessment**

Summarised in easy to understand/review dashboards

Our solutions are flexible and fully tailored to your needs.
Reporting

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**Regulatory environment**

**Reporting**

- **Annual report**
- **Disclosure to investors**
- **Reporting to competent authorities**

**Challenges**

**Moderate**
- People: +
- Data: +
- Tools: +

**High**
- People: ++
- Data: ++
- Tools: ++

**Very High**
- People: +++
- Data: +++
- Tools: +++

**Specific cases of AIFMs managing:**
- Leveraged AIFs;
- AIFs acquiring of non-listed companies and issuers.

**Link to guidelines**
Service offering

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Risk Management and reporting for Real Estate
PwC
“The amount of risk, on a broad level, an entity is willing to accept in pursuit of value”. In other words, Risk Appetite is a high-level statement that sets boundaries on how much risk the organisation is prepared to accept or refuse in order to achieve its strategic objectives.

Used effectively, Risk Appetite provides a structure within which opportunities can be pursued and downsides mitigated by setting out which, why and how much risk the business is willing to take.

Risk Appetite is typically set by Top Management, should reflect investor aspirations and take regulator requirements into consideration.

A well defined Risk Appetite statement should:
- Reflect strategy, objectives, business plans and stakeholder expectations;
- Be periodically reviewed with reference to evolving industry/market conditions.
Per investment (including investment strategies), identification of the key risks to which it is exposed (bottom-up approach). In this context, we will take different types of information into account:

- Information already included in the offering memorandum;
- Detailed analysis of investments in the portfolio and potential investments (according to the investment policy);
- Experience gained through other related assignments.

Definition of the KRI’s to be measured and monitored in order to have an appropriate risk monitoring process in place.

In that context, we will also leverage on the KRI database that we structured throughout the different related assignments we performed.

For each KRI defined, we will recommend techniques to properly measure them considering the information available.

All the KRI’s and measurement methods will be gathered in a dedicated template that will then be used to collect and aggregate data.

In order to allow the Board of Directors to take informed decisions, we will propose a set of risk dashboards properly summarizing the fund’s risk exposure.
All funds impacted by AIFMD/SIF law will have to describe the processes that have been put in place to identify measure, manage and monitor all the risks to which the fund is materially exposed or could be exposed considering, at the minimum: Market risk, Credit risk, Counterparty risk, Operational risk and Liquidity risk.

The risk strategy that has been defined and implemented for all funds (according to step 1) will then be properly documented in the Risk Management Process (RMP) which will include the following key aspects:

1. Governance;
2. Risk identification, measurement, management and monitoring for the main risk categories (i.e. Market risk, Counterparty risk, Credit risk, Operational risk and Liquidity risk);
3. Reporting and escalation procedures.
Following the step 2 and 3 and, based on what will be defined and validated by the client, PwC will then generate the risk reports based on the information (raw data) that will be obtained from the client and produce the risk reports at a frequency defined with the client.

These reports will include the results of all Key Risk Indicators computed as well as a main dashboard summarizing the risk exposures results (traffic light approach giving status against agreed limits).

In order to provide information relevant to the Fund, the defined risk appetite and the current risks exposures will be taken into account for the calibration of our Risk tool will be proposed and validated by the Board of the Fund.
RM for Real Estate – PwC service offering

Main related services:

1. Drafting of Risk Management Processes
2. Risk profiling using a detailed and tested approach
3. Structuring of tailored Risk Management/Monitoring tools
4. Ongoing assistance and production of Risk reporting for Risk Management team/director

**Reporting for Real Estate - PwC service offering**

- Diagnostic
- Recommendation
- Action plan
- Implementation
- Third party review/validation

- AIFMD Regulatory experts
- Risk management experts
- IT experts
- Third party Assurance experts

**Tackling the reporting challenge**
How to meet the new AIFMD reporting obligations

What is the purpose of the new AIFMD reporting obligations?

The new AIFMD reporting obligations are aimed at enhancing transparency and ensuring that investment managers and their firms comply with regulatory requirements. The purpose is to provide a clearer picture of the risks and obligations associated with real estate investments, ensuring that stakeholders can make informed decisions.
Contacts

John Ravoisin
Partner, Real Estate advisory leader
+352 49 48 48 - 5456
john.ravoisin@lu.pwc.com

Benjamin Gauthier
Director, GRC services
+352 49 48 48 - 4137
b.gauthier@lu.pwc.com