INREV Pocket Guide to Secondary Markets

Paper Professional Standards

This short paper provides non-listed real estate investors with a pocket guide to the secondary markets; its uses, benefits as well as some important considerations that should be taken into account as we prepare for the new wave of challenges related to COVID-19.

INREV has two resources that this paper seeks to draw from, namely:

- Pillars to Ensure Open End Fund Liquidity
- Guide to Secondary Trading

Rationale for buying or selling via the secondary market

Most investors choose to increase or decrease their exposure to vehicles for portfolio balancing purposes or due to changes of their investment strategy. Rationale for using the secondary market to do this is typically as follows:

- **For open (and semi-open) end vehicles**, it can allow investors to expedite the subscription or redemption process timeline. Depending on demand, it could also provide pricing advantages relative to the liquidity provisions of a vehicle.

- **For closed end vehicles**, it allows investors to enter or exit before the vehicle's planned liquidity events (e.g. fund wind up or extension).

Vehicle entry or exit options

Vehicle entry or exit can principally be via a primary subscription (or redemption) or a secondary market transaction. Once a closed end vehicle has closed, the only usual option to enter is via a secondary trade. Semi-open end vehicles typically offer periodic primary liquidity options.

The governance for any of the above liquidity tools are typically described in the vehicle documentation (e.g. offering memorandum or limited partnership agreement, etc). Common provisions that will impact secondary market transactions are pre-emption or ROFR (Rights of First Refusal) which means existing investors have priority over available units over new investors.

Investment managers also may have to approve a secondary market transaction (though their approval typically cannot be unreasonably withheld).

Pricing of secondaries; methodologies used

Investors can quote their desired price when buying or selling holdings. This is typically expressed relative to the latest Net Asset Value (NAV), though it can be expressed in value terms. There is no single approach that works for everyone every time.

Whilst NAV is typically a good proxy for value, there are a number of reasons why an investor will have a different view of a holding's worth to them. These include different valuation methodologies and opinions of underlying assets (e.g. INREV NAV), different accounting conventions (e.g. IFRS, US GAAP) and of course different costs of capital.

In addition, most open or semi-open end vehicles will publish multiple adjustments to NAV on a regular basis (usually monthly or quarterly). These can include:

- **Offer price**: The offer price includes the prevailing NAV plus estimated purchase costs of the portfolio (e.g. stamp duty, taxes and brokerage and legal fees)

- **Bid price:** The NAV less the estimated disposal costs of the portfolio (e.g. legal and brokerage fees)

- **Mid-price:** The midpoint between the offer and bid price

Sales considerations

- Who will manage the process (investment manager, seller or advisor)?

- Timing and pricing requirements of the counterparties

- Information provision to the purchaser(s)

- Representations and warranties given to the buyer by the seller
- Settlement considerations:
    - Is a SPA (Sale and Purchase Agreement) and NDA (Non-Disclosure Agreement) required?
    - Is an LOI (Letter of Intent) required by the seller?
    - KYC requirements by the investment manager / fund administrator / counterparties
    - Permission requirements of the vehicle (from the investment manager, other investors potentially via ROFRs and ROFOs)

Secondary market options available to investors

Dispositions of vehicle interests are typically carried out through private relationships of the seller, through intermediation (using a broker at 'best execution' basis) or through placement (an advisor will exclusively promote the vehicle interest at best advantage of the seller). In certain occasions, investment managers are open to offer the shares for sale to other investors in the vehicle or to connect sellers with buyers. We have noted the primary advantages and disadvantages of each:

Options	Advantages	Disadvantages
Request the investment manager of the vehicle to assist with the sales of shares	The manager will likely be familiar with the vehicle's transfer process and some known interested parties.	The manager needs to treat incoming and outgoing investors equally, so will be reluctant to discuss pricing. Intermediating is also not their primary business so will unlikely to be as motivated to find buyers as an advisor who is heavily incentivised to do so.
The seller manages the process themselves	No fees will be payable. Confidentiality will be maximised if the agreement is made by approaching just one party.	The buyer and seller are unlikely to be as familiar with the process or have as strong knowledge of potential counterparties as either advisors or the investment manager, which may impact achievable pricing and timing.
Employing an advisor or broker	They are likely to be more familiar with the buying and selling landscape than most parties. A better price will likely be achieved if a process is run. Some brokers will use a 'best execution' approach, whilst others will use a 'best price' approach. Assistance will be provided in the trade and settlement process.	Fees will be payable.

Contacts

Investors in non-listed real estate can contact investment managers for information on the liquidity provisions of a vehicle. Some managers will assist investors with the process of entering or exiting via the secondary market (typically open end funds).

Alternatively, there are several reputable advisors who are active in the secondary market and are INREV members. Further information can also be sought from INREV.

For further details contact professional.standards@inrev.org.

