

Setting the Right Path for Global Real Estate Standards: Fee and Expense Metrics – Phase I Results



INREV

ANREV

RS NCREIF PREA
Reporting Standards

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Executive summary

Challenge

Investors require more transparency and comparability in the information reported by investment managers, within and across global investment vehicles.

The fees and expenses that are charged by the investment manager of a vehicle are an area that is attracting significant attention from investors and regulators. Practices vary by firm, strategy, product and region. As investment becomes more international, the problem is growing in importance, since terms and definitions differ from region to region.

It is therefore paramount for investors to understand the variations in these terms and definitions in the documentation for specific vehicles.

Purpose

The paper aims to bridge the gaps in terminology and definitions for the most widely used categories of fees that may be charged by an investment manager to their investors, and of costs that may be charged to a vehicle by external service providers.

Outcome and benefits

Investors should now benefit from greater transparency in relation to the fees charged by an investment manager and a better understanding of the types of costs that are charged to a vehicle.

These fee and expenses categories and definitions will bring further clarity to the components of INREV's Total Expense Ratio (TER) and Real Estate Expense Ratio (REER), as well as the NCREIF PREA Reporting Standards Real Estate Fees and Expenses Ratio (REFER).

Introduction

Project background

Current real estate standards relating to the classification of fees and expenses, as well as their measurement and disclosure, are inconsistent globally, limiting the potential for analysis and comparison.

This inconsistency may be seen when considering, for example:

- Whether a fund management fee is the same as an investment advisory fee
- What is generally included in an asset management fee
- Whether one manager includes a cost in their fees while another charges it separately as a fund expense. What is the impact on the fees under both scenarios?
- How one can compare the fees and costs charged by one vehicle to those charged by another

Project description

This inconsistency was one of the catalysts for the collaboration begun in 2015 between INREV, PREA, NCREIF and ANREV, to bring convergence in reporting standards globally.

Under the direction of the Global Standards Steering Committee, which sets priorities for this collaboration, a Fee and Expense Metrics (“FEM”) task force was formed to answer these questions.

A two-phase approach with milestones has been established by the FEM task force. The first phase paves the way for developing a globally consistent set of fee and cost measures. These should be completed under Phase II in 2017, ultimately enabling investors to compare costs across regions, thus enhancing confidence in the non-listed sector.

Implementation of results

The results of the first phase of this project, as presented in this report, are expected to be implemented via TER, REER and REFER guidance papers throughout this year, and will be available for the membership to use as soon as they have been finalised.

In the interim, we hope readers of this report use it to help enhance their understanding of existing fee and cost measures, including TER, REER and REFER.

Guiding principles

Two global guiding principles have been established to offer strategic direction throughout the project. These generic values form the basis for the requirements and best practices of the real estate industry.

1. Comparability

Costs and fees should be consistently categorised and presented, to enable investors and managers to compare vehicle performance.

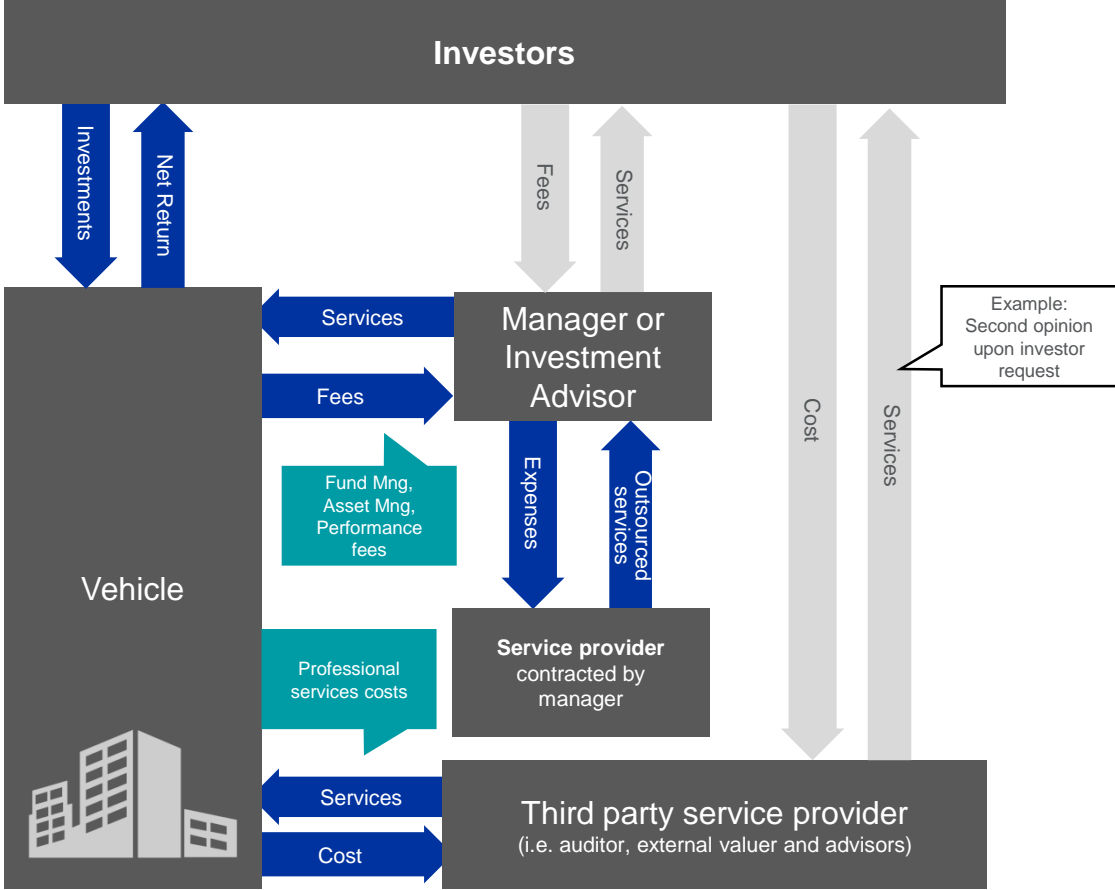
2. Transparency

There should be clear and appropriate disclosure of all the costs and fees charged to the vehicle. Communication of all relevant information should be open, accessible and easy to understand.

Flow and charging of services to the vehicle and its investors

The following graphic shows the structure of services and their providers for a typical real estate vehicle, together with the related flows of fees and costs.

- █ Higher frequency flow
- █ Lower frequency flow



Global overview of existing fee and expense metrics

To enable fair comparison of fees and expenses between vehicles, a set of fee and expense metrics were initially developed within INREV and NCREIF PREA Reporting Standards, in line with their regional guidelines and standards. These metrics are used as the starting point and will be updated in Phase II of the Global Fee and Expense Metrics Project.

INREV TER (Total Expense Ratio)
Vehicle level operating fees and costs as a proportion of INREV weighted average NAV and GAV. Includes fees paid to the manager that are inside the vehicle.

RS REFER (Real Estate Fees and Expense Ratio)
Total fee and expense burden of a real estate vehicle that is calculated as a proportion of the vehicle’s weighted average NAV. Includes fees paid to the manager that are both inside and outside of the vehicle.

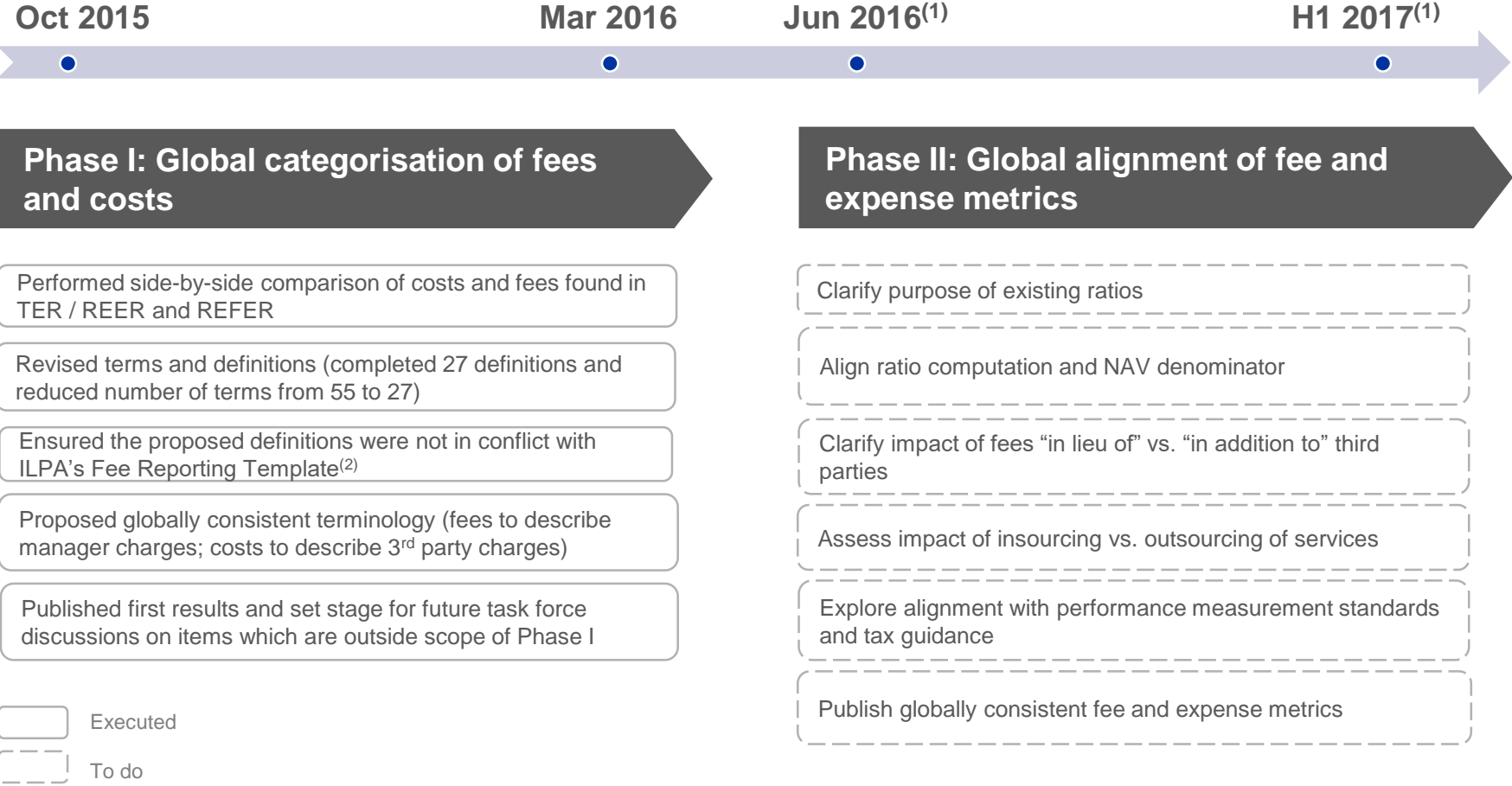
INREV REER (Real Estate Expense Ratio)
Property specific fees and costs as a proportion of INREV weighted average GAV.

Property specific fees and costs
excluded from RS REFER



A two-phase approach to global alignment of standards

Clear project definition and effective planning enabled the task force to arrive at a meaningful converged solution.



Phase I: Global categorisation of fees and costs

Performed side-by-side comparison of costs and fees found in TER / REER and REFER

Revised terms and definitions (completed 27 definitions and reduced number of terms from 55 to 27)

Ensured the proposed definitions were not in conflict with ILPA's Fee Reporting Template⁽²⁾

Proposed globally consistent terminology (fees to describe manager charges; costs to describe 3rd party charges)

Published first results and set stage for future task force discussions on items which are outside scope of Phase I

Phase II: Global alignment of fee and expense metrics

Clarify purpose of existing ratios

Align ratio computation and NAV denominator

Clarify impact of fees "in lieu of" vs. "in addition to" third parties

Assess impact of insourcing vs. outsourcing of services

Explore alignment with performance measurement standards and tax guidance

Publish globally consistent fee and expense metrics

Executed
 To do

Notes:
 (1) Expected dates
 (2) Template launched by the Institutional Limited Partner Association in Jan 2016

Fees paid to the manager

The following fees charged for services provided by the manager were determined to reflect best practice. This list is not meant to be exhaustive but rather to provide further clarity on the fees which are typically incurred by real estate vehicles.

The definition of each item can be found in Appendix B.

Asset management fee	Fund management fee	Property management fee
Internal leasing commissions	Property acquisition fee	Project management fee
Wind-up fee	Property disposition fee	Performance fee

Third party costs at vehicle and property level

Common costs paid to third parties to maintain the operations of the vehicle and to manage its properties include the following. This list is not meant to be exhaustive but rather to provide further clarity on the vehicle and property-level costs which are typically incurred by real estate vehicles.

The definition of each item can be found in Appendix B.

Audit costs	External leasing commissions	Property insurance costs	Valuation costs
Bank charges	Other / Miscellaneous vehicle costs	Property management costs	Vehicle administration costs
Custodian costs	Professional services costs	Taxes on property	Vehicle formation costs
Dead deal costs	Project management costs	Transfer agent costs	
Property disposition costs	Property acquisition costs	Utilities, repair and maintenance costs (non-rechargeable portion)	

Appendices

Appendix B: Globally identified fees and costs (1)

- The detailed schedule of fees and costs presented in this appendix reflects the initial results of the global reconciliation of fees and cost metrics between the INREV Guidelines and the NCREIF PREA Reporting Standards.
- Terms and definitions from the two frameworks were placed alongside one-another, analysed, and a recommendation prepared for each line based on input from the global task force.
- This schedule does not include exempt expenses, and original terms which have been referenced into other terms.

Appendix B: Globally identified fees and costs (2)

Fees paid to the investment advisor or manager:

Global name	Global definition	RS REFER	INREV TER	INREV REER
ASSET MANAGEMENT FEE	<p>Fee typically charged by investment advisors, or managers, for their services regarding the management of the vehicle's assets. Asset management fees generally cover services such as:</p> <ul style="list-style-type: none"> • strategic input and production of asset level business plans; • management of assets including refurbishment; • appointment of third party service providers at asset level; • reporting activities at asset level. <p>Occasionally, asset management fee and fund management fee are combined.</p>	✓	✓	✓
FUND MANAGEMENT FEE	<p>Also known as investment management or investment advisory fees, fund management fees are typically charged by investment advisors, or managers, for their services regarding the management of the vehicle. They generally cover services such as:</p> <ul style="list-style-type: none"> • appointment of third party service providers • reporting activities to investors • cash management and dividend payment • managing the vehicle level structure • arrangement of financing • fund administration • investor relations <p>Occasionally, fund management fee and asset management fee are combined.</p>	✓	✓	
INTERNAL LEASING COMMISSIONS	<p>Commissions charged by investment advisors, or managers, after a new lease or a renewal lease is signed. These include marketing of vacant space. Commission ranges vary and may depend on the market and/or the value of the transaction.</p>			✓
PERFORMANCE FEE	<p>Also known as incentive fees, promote or carried interest, are fees charged by investment advisors, or managers, after a predetermined investment performance has been attained. Carried interest represents a re-allocation of equity and should be treated accordingly for accounting, tax or regulatory purposes.</p>	✓	✓	
PROJECT MANAGEMENT FEE	<p>A fee charged to the vehicle by the advisor, or manager, for guiding the design, approval, and execution of a renovation project, as well as the construction process of a development project. These costs may be expensed or capitalised at the property level.</p>	✓		✓
PROPERTY ACQUISITION FEE	<p>Fee charged by investment advisors, or managers, associated with the closing of a new investment. The fee compensates the real estate investment advisor, or manager, for services rendered in an investment acquisition, including sourcing, negotiating and closing the deal.</p>	✓		✓
PROPERTY DISPOSITION FEE	<p>Fee typically charged by investment advisors, or managers, for services rendered in an investment disposition, including sales marketing, negotiating and closing of the deal.</p>	✓		✓
PROPERTY MANAGEMENT FEE	<p>Fee charged by investment advisors, or managers, for the administration, technical and commercial management of real estate. A property management engagement typically involves the managing of property that is owned by another party or entity. This includes property advisory services.</p>			✓
WIND-UP FEE	<p>Also known as liquidation fee, it is typically found in liquidating trusts, upon termination and dissolution of the vehicle. The sponsor is responsible for liquidating the partnership in an orderly manner.</p>	✓	✓	

Appendix B: Globally identified fees and costs (3)

Costs paid to third parties - Vehicle and property level:

Global name	Global definition	RS REFER	INREV TER	INREV REER
AUDIT COSTS	Costs associated with annual external audit engagements and other audit services provided (both paid to independent third party firms or manager/advisor).	✓	✓	
BANK CHARGES	Costs charged by a financial institution to manage and maintain the cash accounts of the vehicle, or in relation to debt issuance and overdrawing an account. Amounts can be charged on a periodic or transactional basis.	✓	✓	
CUSTODIAN COSTS	Also known as depository costs, these are charged by a fiduciary entity entrusted with holding and safeguarding securities or assets, deposit transactions and keeping records for institutional clients.	✓	✓	
DEAD DEAL COSTS	Costs usually charged by third parties concerning work undertaken for acquisition/disposition projects which do not ultimately close. Such costs cannot be capitalised, and thus must be expensed.	✓	✓	
EXTERNAL LEASING COMMISSIONS	Commissions charged by the listing agent/broker and tenant representative after a new lease or a renewal lease is signed. These include marketing of vacant space. Commission ranges vary and may depend on the market and/or the value of the transaction.			✓
OTHER/MISC. VEHICLE COSTS	Small or infrequent vehicle level costs that are not assigned to other cost categories but are classified as a group. These may include other administration costs, statutory costs, etc.	✓	✓	
PROFESSIONAL SERVICES COSTS	Costs charged at vehicle level in connection with third party services such as accounting, secretarial, legal, tax and other advisory costs, which do not fall into other specific cost categories such as formation costs, valuation costs, etc.	✓	✓	
PROJECT MANAGEMENT COSTS	Costs charged by third parties for guiding the design, approval, and execution of a renovation project, as well as the construction process of a development project. These costs may be expensed or capitalised at the property level.			✓
PROPERTY ACQUISITION COSTS	Direct costs related to a specific property acquisition such as transfer tax, legal costs, due diligence or other closing costs. These exclude costs of running an acquisition program such as general and administrative costs, costs incurred in analysing proposals that are later rejected, joint-venture organisational costs and fees paid to the manager for execution of the deal.			✓

Appendix B: Globally identified fees and costs (4)

Costs paid to third parties - Vehicle and property level (continued):

Global name	Global definition	RS REFER	INREV TER	INREV REER
PROPERTY DISPOSITION COSTS	Also known as disposal costs, they represent the costs of selling an investment property. Disposition costs are typically charged to the seller, and consist of legal fees, title fees and insurance, disposition fees, and broker commissions. Disposition costs include only direct costs related to a property-specific disposal and do not include costs of running a disposition program such as general and administrative costs, costs incurred in analysing proposals that are rejected, joint-venture organization costs or fees paid to the manager for execution of the deal.			✓
PROPERTY INSURANCE COSTS	Expenses related to insurance coverage which is often required by lenders to compensate a property owner and/or lender should the property be damaged by fire, windstorm or other peril.			✓
PROPERTY MANAGEMENT COSTS	Costs charged by third parties for the administration, technical and commercial management of real estate. A property management engagement typically involves the managing of property that is owned by another party or entity. This includes property advisory services.			✓
TAXES ON PROPERTY RELATED ACTIVITIES	Taxes assessed against real property, usually by a country or municipal taxing authority but sometimes also by special purpose districts and agencies, in proportion to the assessed value of the property. Franchise taxes and excise taxes are already included in the NAV, and thus should be excluded.			✓
TRANSFER AGENT COSTS	Costs charged by trustees who are responsible for managing the assets owned by a trust for the trust's beneficiaries. This is most relevant in a REIT structure where trustees act on behalf of all unit holders.	✓	✓	
UTILITIES, REPAIR AND MAINTENANCE COSTS (NON-RECHARGEABLE PORTION)	Shortfalls between the property operating expenses (incl. repairs and maintenance) incurred by the owner of an investment property and the expenses that are charged to the tenants.			✓
VALUATION COSTS	Costs in connection with the external (third party) appraisal of the real estate assets and liabilities owned by the vehicle. Appraisals may be performed routinely or ad-hoc, which can be triggered by certain provisions in the vehicle agreement.	✓	✓	
VEHICLE ADMINISTRATION COSTS	Costs related to bookkeeping activities either paid to a third-party service provider or the manager/advisor.	✓	✓	
VEHICLE FORMATION COSTS	Also known as set-up costs, these charges are incurred at the launch of a vehicle, and do not relate to the portfolio acquisition and financing structure. These include organisational costs (typically legal & notary services) as well as syndication costs, various marketing costs, including printing / publication, and initial subscription fees.	✓	✓	