

FUND ADMINISTRATION

Easing the burden for real estate debt managers

As more alternative asset managers embrace real estate, business has boomed for third-party fund administrators, senior North American Alter Domus executives say

Real estate debt has mushroomed as an asset class, leaving firms with yet another fund vehicle to service. The growth in the strategy has caused some managers, both fledgling shops and established firms, to outsource the administrative tasks required to service a real estate debt fund, say Alter Domus's Doug Hart, regional executive for North America, and Maximilien Dambax, head of fund services North America.

Q Do you believe we are on the verge of a major shift to outsourcing in real estate debt? If so, what are the root causes of this development?

Doug Hart: The big trend in real estate debt with regard to outsourcing is following along the lines of what has started to take place in the real estate equity side and, years before, in the hedge fund space and more liquid space.

In many ways, the complexity of real estate debt structures – the accounting, the systems necessary, the expertise necessary to service a real estate debt portfolio in any format (commingled [fund], joint venture or simple separately managed accounts) – has hit a complexity and cost structure that is very, very difficult to handle in-house.

Maximilien Dambax: If we look at where real estate debt platforms are today, according to CBRE they are the number one alternative for investors.

Over the last three years, we've seen



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Doug Hart

quite an amount of dry powder available in the market. Why? Basically, post-the global financial crisis, there's been two regulations on both sides of the Atlantic: Basel III on the Europe side and the Dodd-Frank Act in the US.

This has created a gap in the capital stack, whereby the banks weren't lending the same as before around value-add equity strategies and construction loans – banks started to stay away from those, or at least compared with where they were in 2008. With active debt fund managers,

we've seen quite an amount of growth.

This is putting a lot of pressure on the real estate debt player that starts to look at outsourcing because there are cost pressures. The investor community has expressed a great preference for the outsourcing model. It offers more transparency.

Q There are different shades to this trend. Could you talk us through those various shades, such as co-sourcing, outsourcing and lift-outs?

DH: What we're seeing in the marketplace is that one flavour does not fit all.

In the case of large established investment managers, we're seeing a trend toward lifting out a component of their operating team or, in some cases, their full operations team, to the outsource provider. What it does at the high level is it essentially creates an infrastructure around the operations team that they did not have in-house.

Co-sourcing is a style where the investment manager is comfortable in having their system in-house or parts of their data in-house but are not either familiar or capable or have the resources to service a component of their operations. That could be a new fund structure or a new function within their overall operations.

The third flavour is more just a new investment manager or an existing investment manager starting a new fund and wanting that fund or portfolio administered by an outsourced services provider.

Q It's a highly competitive environment for real estate debt managers. Does that have cost implications and, if so, in what ways?

DH: There's a few themes to the outsourcing trend. We mentioned complexity and systems earlier. But the cost structure for an investment manager is impactful to the yield, to the returns – both at the GP level and at the LP level.

As the efficiency of an outsourcer is brought to one competitor, it can add, to some degree, a yield advantage to the LP or a cost advantage to the GP. It's not just staff; it's not just systems. They are very expensive, they are very complex.

But it's also the knowledge gap – just not knowing if a new fund is introduced or a new structure is introduced. An outsourcer will likely have had experience in that new structure and bring [that new structure] to bear, and not go through the training or system build required of an in-house manager.

MD: These technology challenges are also impacting large asset managers. They are often looking at the in-house technology function and thinking about a specialised external offering such as a redesign or embracing a technology service provider. It's not only the first-time fund managers but also the large asset managers that are affected today.

Q Presumably timing of information and ensuring efficient cashflow are among the most important issues for managers. What kinds of technological innovation are we seeing in these areas?

MD: The cashflow side is moving away from a world of complex and unreliable spreadsheets to specialist systems. There are integrated loan-administration and fund-accounting functions with daily reconciliations in place to better monitor risk exposure and support the investment manager in their investment thesis.



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For many, it's crucial to have timely access to portfolio cashflows and returns. This needs to provide them with the ability to slice and dice by industry, rating, size and type, in order to provide them with data points that enable them to transact, monitor and report back to the investor.

I would say that it's not necessarily focusing on the cashflow side but on the technology side. I think in this environment, cybersecurity is also a hot topic. It's impacting today the overall universe of asset management.

DH: What's particularly unique about real estate debt is you have payments coming through on a daily basis, you have different yield maintenance-type calculations, you have paydowns. You have the operations of the fund. The accounting of the fund has to be very asset oriented, or loan-servicing oriented.

The operations team supporting the front end has to be a servicer – an advanced reporting agent – and then you're providing a professional accounting overlay on top of all that. All of that working together makes real estate debt a little unique when compared with the other sectors.

Q When it comes to loan-to-own strategies, how can you ensure a seamless transition from debt to equity structures?

MD: Post-financial crisis, there were plenty of real estate-owned structures following loan foreclosures and bank loan restructurings. Those strategies fit well with the administrator space, having dedicated real estate equity and real estate debt teams whose platforms support transactions at both the holding company and asset level.

The key is to build out the collateral for the loan in addition to the loan itself, so that reporting is consistent through transition, and to leverage administrators' loan servicing and property-level accounting services.

Q I understand you are active in the infrastructure and project loan space. Are the dynamics there essentially the same as for real estate, or are there differences?

DH: In many ways it's an amalgamation of what we just spoke about. You have the accounting at the asset level, and you have the loan servicing at the asset level. But what infrastructure brings that adds a layer of complexity is the various components surrounding the project itself: municipalities, guarantors. The servicing of infrastructure loans can be incredibly complex, not just at an asset level but at various stages of the project coming to life. ■

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