



# REAL ESTATE LAW & INDUSTRY



VOL. 3, NO. 3

**REPORT**

FEBRUARY 9, 2010

**FIDUCIARY STANDARDS**

## Asset Review Monitoring System Helps Real Estate Firms Meet Fiduciary Obligation

BY STEPHEN R. GANNS

**G**lobal Investment Performance Standards (GIPS) Fiduciary Definition: A person to whom property or decision-making authority is entrusted on behalf of another. The word itself comes originally from the Latin *fides*, meaning faith, and *fiducia*, trust.

In July 2009, the Organisation for Economic Cooperation and Development (OECD) updated its guidelines for Pension Fund Governance. The revised guidelines include: (1) Risk management procedures, (2) effective committees/decision-making bodies that are qualified and trained, (3) written compliance policies, (4) accountabilities regarding conflict of interest, (5) supervision and monitoring, and (6) effective reporting and information flows.

In an article written by David M. Furbush and Nathaniel M. Cartmell *Pension Plan Fiduciaries: When Is There a Duty To Investigate?* the Employee Retirement Income Security Act (ERISA) "prudent man" standard is discussed. This requires a fiduciary to act with care, skill, prudence, and diligence under the circumstances. It is important to investigate after initial investment decisions are made; for instance, when an investment is not producing the anticipated returns. Additionally, ERISA imposes a duty on each fiduciary to prevent and/or correct any known breaches of fiduciary duties by other fiduciaries.

Consultants, investment managers, and plan sponsor administrators carry a significant fiduciary responsibility regarding investment portfolios. As such, we would

propose the Asset Review Monitoring System for Compliance that is designed to provide real estate compliance/quality control services and valuation report monitoring processes and procedures.

**Importance of Asset Review and Monitoring.** The sheer size of plan sponsor real estate portfolios coupled with the rebalancing of these portfolios establishes the need for very precise metrics for performance measurement, analyses to effect proper asset management, and the provisioning of reliable and accurate data for fiscal purposes.

**Asset Review Monitoring System for Compliance.** In its essence, an Asset Review Monitoring System (ARMS) for Compliance is an extension of and is fully aligned with the plan sponsor real estate investment office and system, coordinating services between internal departments, consultants, and external investment managers. ARMS should act as the quality assurance or compliance arm for internal real estate investment officers and portfolio managers, providing essential data in a concise format such that real estate staff and consultants are able to perform the function of building and managing the portfolio.

An asset review monitoring system would be initiated by the plan sponsor to review investments in new managers and, importantly, monitor or perform compliance procedures on investment activity, asset performance, and overall program performance.

ARMS would monitor and standardize the entire life cycle of the investment manager in which there are several key events/occurrences:

- approval and funding of investment manager/fund,
- new manager orientation,
- monitoring the rate of the capital deployment/capital call,
- investment manager quarterly reports,
- investment manager annual strategic plans/reports along with any additional necessary documentation,

*Stephen R. Ganns is managing director of Situs Strategic Advisors, a division of The Situs Companies, which is an integrated global consulting firm specializing in real estate advisory and derivatives support services.*

- the asset management fee calculation,
- the incentive fee calculation period, and
- extension of the funding period, if applicable.

An asset review monitoring system would provide assistance in the orientation process of new managers or funds as to fiscal reporting processes and with the requirements of the plan sponsor investment office, legal departments, and plan sponsor internal valuations. Additionally, asset review monitoring should assist these departments within the plan sponsor and consultants to interface with the investment managers to collect reliable and accurate information.

As part of the monitoring/compliance process, an asset review monitoring system should collect data that may include, but is not limited to, quarterly reports, annual business plans, operating and financial performance reports, strategic plans for investments, geographic market data, future acquisition and development plans, sales and marketing strategy reports, hold/sell analyses, debt position analyses, interest rate management analyses, and incentive/asset management fee calculations. Asset review monitoring, upon completion of a yearly review, would provide an annual asset summary report to the plan sponsor investment officer and portfolio manager.

Asset review monitoring may also conduct meetings with managers and/or site inspections of the properties within the portfolio. If a site inspection is completed, the inspection reports should be included in annual asset summary report in the year in which the inspections

are performed. In short, an asset review monitoring program would conduct analyses relating to financial and operating performance and then will issue reports to the appropriate departments within the plan sponsor.

The system would also develop and maintain a manager evaluation policy that monitors the manager's investment activities as well as the manager's operations. Managers should be rated based on performance in both categories. For investment managers that violate the quantitative or qualitative criteria of the manager evaluation process, the manager will be put under a more strenuous review. This review should include collection of additional data, more in depth analysis of the manager's operations, and a formal meeting/interview. If the manager receives a satisfactory rating during the manager review period, the manager would be retained; however, if a manager receives an unsatisfactory score, the manager removal process may possibly be initiated.

An asset review monitoring system would also complete macro attribution analysis for the fund's real estate investment program and micro attribution analysis for the individual property types. Within this framework, recommendations can be made to enhance returns.

Asset review monitoring would also act as a check for the investment officer of the appraisal/valuation process and its results. Once the plan sponsor internal valuations has received the property or partnership appraisal or valuation, asset review monitoring will complete a valuation review for the plan sponsor investment office as part of the yearly asset summary report.

**ARMS and Portfolio Structure.** ARMS should be combined with a total investment return structure to take into account the effect of market conditions (alpha and beta) and the effect of gamma or the management process (including returns from: leverage management, property sector/property class selection management, selection of specific properties, operational income, realized gains and unrealized gains).

**Final Comments.** In the final analysis, an asset review monitoring system would operate as the internal quality control or compliance platform for plan sponsor real estate investments and portfolios, internal valuations, plan sponsor consultants, real estate investment managers, and external appraisal/valuation firms.