Unlisted real estate slow to react to regulation, shift to DC

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UK – Asset managers must develop new types of unlisted real estate products because of big changes in regulation, the pensions shift to defined contribution (DC) and societal change in Asia, a real estate seminar heard.

John Forbes, partner at PwC, said at the IP Real Estate Awards in London: "There is a significant opportunity for product development in the real estate investment management industry."

Investors are now invested in funds that do not deliver what the investor went into the funds to achieve, he said.

Some investors are invested in open-ended funds not because they want to have liquidity, but because they wanted to deploy their capital for the long term, and are not attracted to the straitjacket and fixed timetable of closed-end funds, Forbes said.

"Those investors are paying a very significant cost for liquidity they have no intention of using," he said.

There was a number of other reasons why now was a fertile time for product development, he said.

"We are at a significant changing point in the sources of capital to invest in real estate," he said.

The pensions industry is changing from defined benefit (DB) to DC provision, and the industry had not yet adjusted to that new source of capital, he said.

"The massive growth over the next decade is going to come from the middle classes in Asia, providing for their old age through pensions and life insurance," said Forbes.

"The growth in the Asian middle class piling money into life products and pension products is going to create a sea change in the availability of capital.

"We are in a period of significant regulatory change."

This, he added, is creating opportunities to devise new kinds of products that have not been there before.

Forbes was speaking on the topic of unlisted property funds, focusing on lessons to be drawn from the market crisis.

Outlining research published last year on the subject, he said there had been shown to be an inherent non-alignment of interest that had to be managed and mitigated.

The areas of non-alignment of interest were between investors in the fund and the fund manager, between one investor and another, as well as between those who realise capital and those who deploy it.

Forbes said there were a number of key findings in the report that the Association of Real Estate Funds was now taking forward.

"That process is underway, but I don't think real estate managers need to wait for that process," he said.

"Dealing with these issues creates the opportunity for fund managers to differentiate themselves and create new fund products."

Although the report was commissioned for the UK market, some of the consequences at the fund level are greater outside the UK – and these areas are receiving greater regulatory attention, he said.

But the big difference between the UK market and others is that it has changed significantly over the last 18 months, he said.

When the report was written, he said, regulation in the UK had not been of major concern to the UK real estate investment market.

"That is changing dramatically across Europe because regulation is going to be a very major consideration going forward," he said.

He cited the Alternative Investment Fund Managers Directive (AIFMD) as an example, which is set to take effect on July 22 with a one-year transition period.

"All of this will push up costs, so the long-term impact of the changed attitude of investors and regulators – as well as creating an opportunity for product development – also creates a major cost challenge for real-estate investment managers," he said.

This would result in consolidation in the industry and the development of new business models for real estate investment managers, he predicted.