HOME, SUITE HOME

BY SADIQ ALLADINA

Six tips to monitor your real estate advisor more effectively

Smaller pension funds tend to rely more on external fund managers and often access direct real estate via open or closed-end commingled funds (consisting of several accounts that are pooled together) with a limited partnership structure, using an investment style in which the risk ranges from minimal to moderate. Here are a few key areas to consider when monitoring a real estate advisor.

1) Capital Call Limited partners (investors) have a legal obligation to provide capital whenever called by the general partner (advisor). The process is often consensual, but limited partners are legally obliged to defer to the general partner in the case of a disagreement.

2) Credit Checks While it's possible to order credit reports for publicly traded companies, many tenants are private and determining their creditworthiness requires fluency with financial statements. At least one person on the investment team should be able to evaluate a tenant's financial health in order to help secure stable cash flows from the real estate portfolio.

3) Disposition Despite the temptation to sell a stabilized asset (i.e., one that has almost full occupancy and doesn't require additional improvements) on schedule, its role in the overall portfolio of keeping the cash flow positive is crucial. Never view assets in isolation. Often, one asset cross-subsidizes another, making disposition timing more complex than it appears.

4) Pressure to Buy In a frothy market like the current one, real estate deal-making can be tough due to competition. Your advisor may want to place as much equity as possible in one fell swoop, sacrificing a meaningful level of sector and geographic diversification. You can address this with limits on concentration and an incentive fee based on performance rather than acquisition.

5) Rigour The investment process should be rigorous enough to prevent rash decisions, and advisors should always ask how the assumptions imbedded in their valuations for acquisition and disposition are viewed by investors. An on-site file review of documents covering the entire investment cycle is a good way to gauge an advisor's adherence to the process and the quality of analysis used for decision-making.

6) Bad Times It's easy to meet return requirements at a time of compressing yields, but the cyclicality of real estate means that the advisor needs a strategy for weathering downturns while considering four areas in particular.

- **Operations** Reduce operating costs and appeal tax assessments. Scale back capital expenditure programs and resume them after the market recovers.
- **Leasing** Deal with tenant renewals early and scrutinize tenant covenants. If the downturn is expected to be short, emphasize short-term renewals, which allow you to re-lease the space at a better rate when leasing conditions improve.
- **Acquisitions** Restrict prospective deals to primary markets. Prioritize cash returns over capital appreciation. Explicitly reflect existing conditions in the investment analysis. With dispositions, prioritize stabilized assets and focus on the buyer's credibility.
- **Mortgage financing** Seek the terms-and-conditions agreements from lenders early in the acquisition process and secure financing before committing to the deal. Use more equity in riskier sectors and leverage in more financeable ones.

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THE MAGIC *Number*

THE AVERAGE REAL ESTATE ALLOCATION FOR CANADIAN PENSION FUNDS IN Q3 OF 2013 WAS

8.2%

Source: Statistics Canada

Knowing these issues will allow pension funds to better monitor their advisors. BC

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