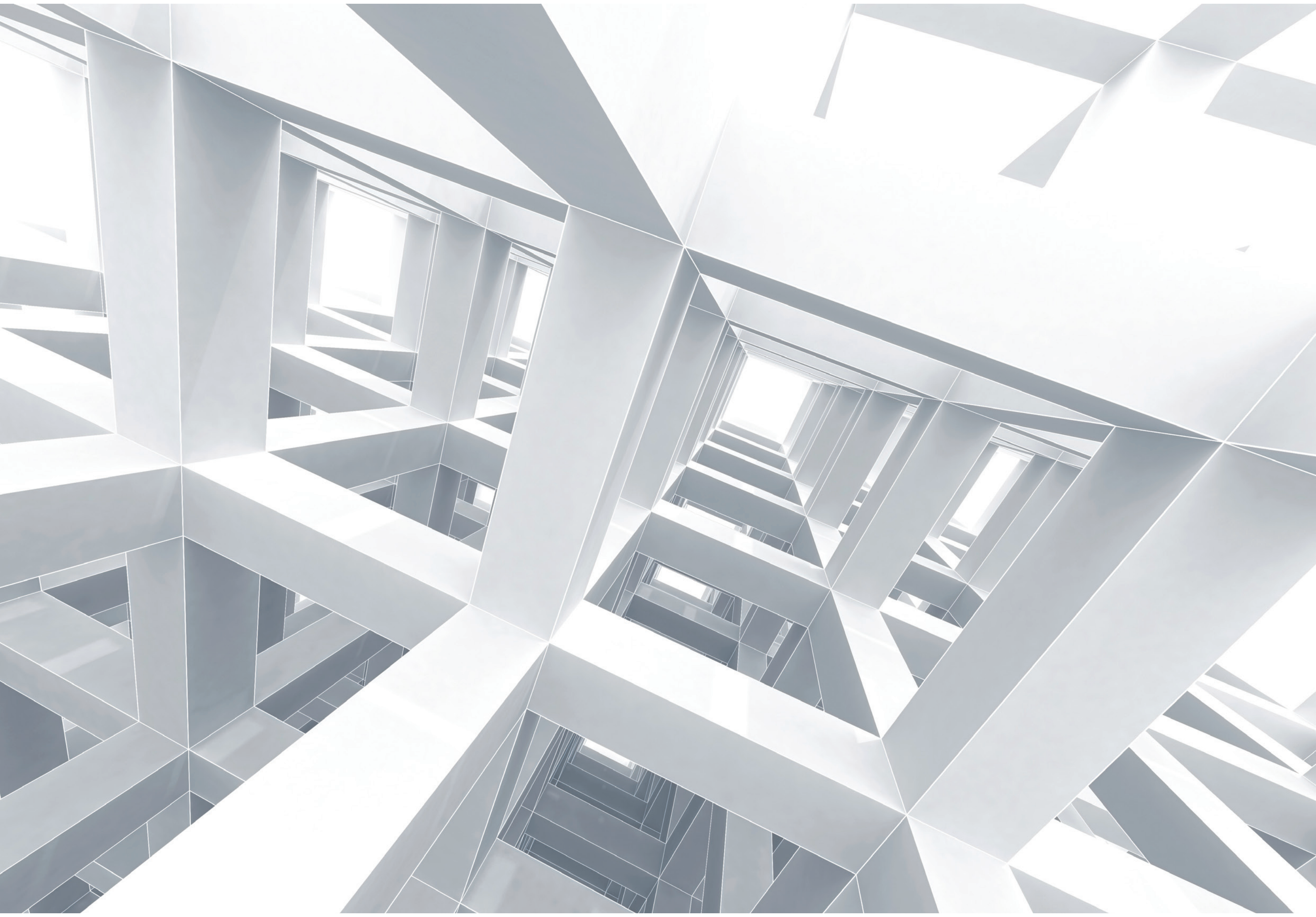
RICS guidance note

RICS professional standards and guidance, Europe

Real estate risk management under the Alternative Investment Managers Directive (AIFMD)

1st edition, November 2017



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This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice', i.e. recommendations that in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the guidance note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this guidance note, they should do so only for good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice.

Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In some cases there may be existing national standards that may take precedence over this guidance note. National standards can be defined as professional standards that are either prescribed in law or federal/local legislation, or developed in collaboration with other relevant bodies.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member's responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

Document status defined

RICS produces a range of professional standards, guidance and information documents. These have been defined in the table below. This document is a guidance note.

Publications status

Type of document	Definition	Status
Standard		
International standard	An international high-level principle-based standard developed in collaboration with other relevant bodies.	**Mandatory.**
Professional statement		
RICS professional statement (PS)	A document that provides members with mandatory requirements or a rule that a member or firm is expected to adhere to. This term also encompasses practice statements, Red Book professional standards, global valuation practice statements, regulatory rules, RICS Rules of Conduct and government codes of practice.	**Mandatory.**
Guidance and information		
RICS code of practice	Document approved by RICS, and endorsed by another professional body/stakeholder, that provides users with recommendations for accepted good practice as followed by conscientious practitioners.	Mandatory or recommended good practice (will be confirmed in the document itself). Usual principles apply in cases of negligence if best practice is not followed.
RICS guidance note (GN)	Document that provides users with recommendations or approach for accepted good practice as followed by competent and conscientious practitioners.	Recommended best practice. Usual principles apply in cases of negligence if best practice is not followed.
RICS information paper (IP)	Practice-based information that provides users with the latest technical information, knowledge or common findings from regulatory reviews.	Information and/or recommended best practice. Usual principles apply in cases of negligence if technical information is known in the market.
RICS insight	Issues-based input that provides users with the latest information. This term encompasses thought leadership papers, market updates, topical items of interest, white papers, futures, reports and news alerts.	Information only.
RICS economic/market report	A document usually based on a survey of members, or a document highlighting economic trends.	Information only.
RICS consumer guide	A document designed solely for use by consumers, providing some limited technical advice.	Information only.
Research	An independent peer-reviewed arm's-length research document designed to inform members, market professionals, end users and other stakeholders.	Information only.

1 Introduction

The *Alternative Investment Fund Managers Directive* (AIFMD) has made risk management one of the fundamental functions for real estate investment funds. Although the Commission Delegated Regulation (EU) No 231/2013 supplementing the Directive (Level II) has further clarified the type of risks that need to be addressed for alternative assets, specific guidance on real estate risks has not yet been provided.

Given the importance of real estate for Europe's alternative investment fund industry (according to the INREV Vehicles Universe Q2 2017, there are 456 funds with total gross assets under management of 280 billion euros), RICS Europe has produced this guidance note to provide guidance to AIFMs on risk management for real estate investment funds. The guidance note is the outcome of a thorough consultation with senior industry professionals responsible for risk management within tier one institutional real estate asset management firms. RICS and the authors of this guidance note would like to thank all contributors for their valuable feedback during several rounds of consultation.

For the avoidance of doubt, we would like to emphasise that this guidance note has been written from the perspective of the AIFM real estate risk management function. In accordance with the Directive, the AIFM is responsible for the following three main functions:

- portfolio management
- risk management
- valuation.

In most cases, AIFMs will be supported by either a portfolio manager or an investment advisor to fulfil their day-to-day duties in relation to portfolio management (respectively through a delegation of the portfolio management function or an outsourcing of different investment management tasks via a service agreement). Moreover, it is clear that real estate risk management (e.g. with respect to risks at the level of real estate assets, portfolios and funds) is already embedded in the day-to-day duties and responsibilities of investment advisors. In this context, the role of the AIFM risk management function will be to ensure proper oversight of day-to-day risk management performed by the investment advisor and either executing or overseeing existing controls, including independent reviews and assessments of the work performed by the investment advisor.

This guidance note therefore assumes that risk management is generally implemented through three lines of defence:

- the investment advisor or portfolio management function as first line of defence
- the AIFM risk management function as second line of defence and
- the internal audit function of the AIFM as third line of defence to ensure that the overall internal control system and risk management framework operate effectively.

1.1 Purpose

The purpose of the guidance note is to:

- create a standard library of real estate industry risks
- develop specific guidance on real estate risk management to assist AIFMs on questions such as:
  - what the role of the AIFM real estate risk manager is
  - what the specific checks and controls that need to be implemented by the AIFM risk manager are
  - how to identify key risks for the various property sectors and real estate investment styles
  - which type of risks should be emphasised throughout the real estate investment life cycle (i.e. acquisition, holding, disposal phase)
- provide an example of an AIFM real estate risk management framework for a direct European core office fund (Appendix A: core office risk matrix).

It is anticipated that the AIFM real estate risk management framework in Appendix A could serve as a basis for real estate funds investing in other real estate sectors and/or applying different investment styles.

A glossary is provided in Appendix B for information purposes.

1.2 Target audience

This guidance note is relevant to:

- RICS members
- real estate professionals and
- the wider AIFM stakeholders' community, including AIFM real estate risk managers, investment/portfolio managers, investment advisors, investment/valuation committee members, board members and investors.

1.3 Effective date

This guidance note is effective from 1 March 2018.

2 The role of the AIFM real estate risk manager

2.1 Main tasks and key challenges

The main tasks to be fulfilled by the AIFM real estate risk manager can be summarised as follows:

- identify key risks and determine key risk indicators
- set limits/thresholds for key risk indicators in accordance with the risk profile of the fund
- measure or monitor key risk indicators
- perform or supervise stress tests and sensitivity analysis on given key risks
- monitor risk mitigating steps and follow up on remedial actions in case of exceptions or breaches
- report to the board of the AIFM (highlighting exceptions and remediation actions) and
- ensure that appropriate risk management disclosures are made to investors and the required risk reporting is provided to regulators.

To fulfil these tasks, the AIFM real estate risk manager needs to have a clear understanding of the underlying real estate assets and the investment strategy of the fund. He or she also needs to have the ability to interact with various stakeholders (e.g. fund manager, fund controller, asset/portfolio manager, investment advisor, property manager, etc.) in order to address questions timely.

Furthermore and in compliance with the AIFM Directive, it is important to note that the AIFM real estate risk manager has timely access to all relevant reports that exist within the organisation in order to perform its duties effectively.

In this context, the board of the AIFM acts as escalation point.

2.2 Types of controls performed by the AIFM real estate risk manager

The types of controls generally fall into two categories:

- **Controls based**: the AIFM real estate risk manager leverages off existing controls implemented by the first line of defence that cover the various activities of the fund (e.g. acquisition, asset/portfolio management, debt management, etc.). It requires the AIFM real estate risk manager to have a clear understanding of the roles and responsibilities of the various stakeholders of the fund (such as portfolio, asset and property managers, investment advisors and fund controllers) as well as a clear overview of the internal reporting process. The AIFM real estate risk manager will need to ensure that the controls in place are appropriate, effectively documented and performed on a regular basis. Where there are control deficiencies, the AIFM real estate risk manager should discuss them with the relevant stakeholders and escalate/report any findings to the AIFM Board together with a remediation plan.
- **Detailed testing**: the AIFM real estate risk manager directly performs specific tests of detail. This covers activities such as investment restriction reviews, independent valuation reviews, performance calculation reviews, financial model reviews and stress testing. These specific tests usually include tasks such as:
  - sample checks performed on specific reports (e.g. reconciliation, mathematical checks, accuracy, completeness and consistency)
  - challenging key data by requesting and reviewing adequate supporting documentation (e.g. valuation assumptions, performance assumptions, etc.).

The frequency of controls (for both controls based and detailed testing) generally depends on the risk type, the characteristics of the fund (e.g. open-ended versus closed-ended, investor reporting requirements, etc.) and regulatory requirements. The AIFM real estate risk manager needs to prioritise tasks by assessing key risks based on his or her professional knowledge and experience.

3 Defining the approach of the AIFM real estate risk manager

3.1 Identifying key risks

The characteristics of the underlying real estate assets are key in developing the AIFM real estate risk management framework. Therefore, a 'bottom-up approach' needs to be taken, with:

- a first phase focusing on key risks present at **asset level** (e.g. asset quality, quality of tenants, lease duration, valuation, etc.) and
- a second phase focusing on key risks present at **fund level** (e.g. investment restrictions, fund performance, tenant/industry concentrations, etc.).

It is useful to highlight that potential tax and legal risks associated with typical multi-layer real estate fund structures (i.e. fund-holdco-SPV) are usually considered as fund level risks.

3.2 Tailoring the AIFM real estate risk management framework

Given the variety of risk/return profiles in real estate, there is no 'one-size-fits-all' approach for real estate risk management.

One of the objectives of the AIFM real estate risk manager is to ensure that the risk profile of the underlying real estate assets (both individually and in aggregate) are in line with the investment style of the fund and risk appetite of its investors, so as to ensure that the AIFM is in alignment with its mandate.

3.2.1 Determining the investment style

The investment style classification defined by INREV provides guidance to the AIFM real estate risk manager to differentiate between the main real estate investment strategies (i.e. core, value-added, opportunity) according to indicators such as % loan-to-value (LTV) or % target return derived from income, as shown in the INREV table below.

3.2.2 Setting risk limits and thresholds

The determination of quantitative and qualitative risk limits and thresholds enables the AIFM real estate risk manager to better tailor the risk management framework to the specific risk profile of a fund.

Such limits and thresholds are applied to key risk indicators, which (for some of them) are specific to a given property sector. Commonly used indicators for income-producing assets are, among others:

- % occupancy rate
- WALB (weighted average lease period until the first break option)
- % LTV and compliance with other debt covenant ratios (e.g. ISCR, DSCR)
- credit quality of tenants
- geographical, tenant and industry concentration.

The standard set of key risks is fairly similar for most income-producing real estate assets regardless of the property sector. For example, an LTV ratio or a WALB will be common key risk indicators across the different property sectors. However, certain business risks can be sector specific, such as % turnover rent or the occupancy costs-to-sales ratio for a retail asset.

As the case may be and in accordance with INREV investment style classification, European core office funds might opt for an up to 5% (re)development investment exposure. Commonly used key risk indicators for (re)development projects are, for example:

- % of pre-let rentable area
- credit quality of developer.

	Core ≤ 40%	Core > 40%	Value added	Opportunity
Target percentage non-income producing investments	≤ 15%		> 15% – ≤ 40%	> 40%
Target percentage of (re)development exposure	≤ 5%		> 5% – ≤ 25%	> 25%
Target return derived from income	≥ 60%			
Maximum LTV	≤ 40%	> 40%	> 40% – ≤ 60%	> 60%

The above table from the INREV *Style classification snapshot* is reproduced with permission from INREV.

3.3 Considering the life cycle of a real estate investment

The life cycle of real estate investments – from acquisition to holding and disposal phase – has a great influence on key concerns, risks and priorities of the AIFM real estate risk manager.

3.3.1 Acquisition phase

Given the inherent illiquidity of real estate assets, a particular focus should be given at the acquisition stage.

The key objectives of the AIFM real estate risk manager at the acquisition stage are:

- to ensure that the risk profile of the target investment is aligned to the investment style and risk profile of the fund and
- to identify any issues from the due diligence that need to be addressed prior to the closing of the acquisition and reported to the investment committee or the board of the AIFM.

In order to achieve this, the AIFM real estate risk manager will usually adopt a controls based approach focusing on tasks performed by the investment advisor on key areas such as:

- legal, tax, financial, environmental and technical due diligence findings (ensuring that all potential risks have been identified and properly reported)
- asset valuation (ensuring that target assets have been properly valued, in accordance with market standards, and that underlying valuation assumptions are reasonable) – it is considered to be best practice for European core real estate investment funds to value real estate prior to the acquisition
- key portfolio ratios and indicators (ensuring that key metrics are in line with targets and the investment style of the fund, e.g. debt covenants, WALB, vacancy, internal rate of return, etc.)
- reporting on the sustainability characteristics of the asset, including social aspects (ensuring assessment of obsolescence risk)
- coordination and review of legal agreements.

It is therefore fundamental for the AIFM real estate risk manager to be involved in the early stages of the acquisition process and to perform the initial risk assessment **before** the letter of intent is issued, and the detailed risk assessment **before** the transaction is subsequently approved by the investment committee and/or the AIFM. Furthermore, the AIFM real estate risk manager should ensure that key risks have been appropriately addressed and documented in the investment memorandum supporting the acquisition.

3.3.2 Holding phase

During the holding phase the priority of the AIFM real estate risk manager changes towards monitoring the effectiveness of existing controls to mitigate risks that have been identified during the initial due diligence or that may occur during the holding period.

Moreover, monitoring and reporting on potential changes (e.g. with respect to the overall performance of the fund) or breaches of risk limits or thresholds and following up on potential remedial actions is central to the role of the AIFM real estate risk manager in this phase. The frequency of the risk analysis could vary by product, but it is reasonable to link it to the NAV calculation frequency. Stress testing and back testing techniques are used to support the monitoring and assessment exercise. These assessments should be conducted at least on a yearly basis.

3.3.3 Disposal phase

During the disposal phase of assets and the liquidation and wind up of the fund thereafter, the AIFM real estate risk manager will usually again adopt a controls based approach focusing on tasks performed by the investment advisor on key areas such as:

- timing of the disposal process and market value of the assets considering their liquidity, the business plan, the impact of the disposal on fund risk and the term of the fund
- due diligence on the selected bidders (e.g. solvency, reputation etc.)
- contractual obligations, guarantees and commitments resulting from the disposal/ liquidation process.

The AIFM real estate risk manager should ensure that such key areas have been appropriately addressed and documented in the disposal memorandum supporting the transaction.

4 Implementing valuation controls

4.1 Independent valuation review process

Given that the AIFM is responsible for the valuation of the assets of the fund, the AIFM real estate risk manager needs to ensure that an independent, transparent and documented valuation review process is implemented irrespective of the valuation model adopted by the AIFM (internal v external valuation model) and the related impacts on liability (see article 19 of the Directive 2011/61/EU and also refer to the RICS Briefing Note dated February 2015 on *Valuations in accordance with the Alternative Investment Fund Management Directive*, available at www.rics.org/Documents/Alternative%20Investment%20Fund%20Managers%20Directive.pdf).

The valuation review process should also be independent from the portfolio management function as well as from the investment advisor and should at least include the following tasks:

- checking the independence (e.g. organisational charts, remuneration policy, past appointments, conflicts of interest, etc.) and competence/professional qualifications (e.g. RICS Registered Valuer accreditation) of the external appraiser
- ensuring that the appointment of the external appraiser complies with local regulatory requirements and professional standards (e.g. IVS and *RICS Valuation – Global Standards*, the 'Red Book')
- checking the accuracy and completeness of the valuation source data provided by the property/asset manager to the external appraiser (i.e. rent rolls, capex budgets, etc.)
- checking the accuracy, consistency and completeness of the external appraisers' report, and in particular the rationale used to select the valuation methodology/model(s) and the documentation supporting the underlying valuation assumptions (such as comparables for example)
- reviewing the value changes (or the absence thereof) between two review cycles.

The consistency of the valuation methodology over time and across the various assets of the fund should also be checked by the AIFM real estate risk manager.

4.2 Scope and frequency of independent valuation review

The scope (i.e. limited or full review) and frequency of the independent valuation review will depend on the characteristics and reporting requirements of the fund (i.e. open-ended v closed-ended, frequency of property valuation, frequency of NAV calculation and of investor reporting, etc.). However, the frequency of the review should at least be annual.

4.3 AIFM real estate risk manager involvement

It is of paramount importance for the AIFM real estate risk manager to be involved in the various steps of the independent valuation review process by either performing the review him or herself (if the appropriate competence and skills are in place) or by having proper oversight on the review process performed by an independent third party reviewer.

5 Conclusion

The set-up of the AIFM real estate risk management function might be specific in each and every real estate business organisation, as it depends, for example, on the size of the organisation, the amount of assets under management and the available resources.

On the other hand, there is no doubt that AIFMD has increased the need for qualified and industry-knowledgeable personnel at the level of the AIFM, which is of paramount importance to properly carry out its duties, notably with respect to risk management. Indeed, AIFMs are facing increased pressure and scrutiny to demonstrate appropriate substance, independent controls and oversight. This currently represents a challenge for AIFMs looking to hire staff with adequate real estate competence, skills and experience.

Appendix A: Core office risk matrix

Asset level risks (unlevered and levered)

Risk category	Risk	Key risk indicator (KRI)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Market risk	Macro-economic risk	Country rating	Decrease in country rating	At acquisition: macro-economic/real estate market risk to be analysed by transaction team to ensure alignment with investment strategy and reported in 'investment committee' paper During holding phase: asset/portfolio manager to monitor macro-economic/real estate market risk and issue 'market risk' report At disposal: asset/portfolio manager to assess timing versus business plan of the fund	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review 'market risk' report At disposal: review, comment and sign off disposal paper prior to transaction approval
		GDP	Decrease in GDP		
		Unemployment at country level	Increase in unemployment rate		
		Political stability	Political instability estimate, presence of violence and terrorism		
		LT interest rates	Interest rate volatility		
	Rental market risk	Market vacancy	Increase of average vacancy rate on the market on an annual basis		
		ERV	Decrease in ERV trend		
	Investment market risk	Prime market yield	Volatility of prime market yields on an annual basis (for offices)		
Credit risk/ counterparty risk	Tenants' insolvency	Credit quality of tenants	Decrease in credit quality of tenants (if credit rating not available, alternative procedures may be used to assess solvency)	At acquisition: perform financial due diligence to highlight potential doubtful debtors During holding phase: property manager to monitor timely payment of rents and to issue 'rent status report' highlighting delays/defaults (including remediation actions)	At acquisition: ensure such due diligence procedure is properly performed During holding phase: obtain and review 'rent status report'
	Default of financial institutions holding cash deposits/loans	Credit ratings of financial institutions	Decrease of credit quality of financial institutions	Discuss, document and track dialogue (i.e. decrease in credit quality temporarily acceptable, initiatives taken to closely monitor counterparty solvency, etc.)	Review governance process (e.g. methodology to determine counterparty solvency, use of several independent sources of information)
	Default of counterparty in the context of an interest rate or currency swap	Credit rating of OTC counterparty	Decrease of credit quality of financial institutions		

Risk category	Risk	Key risk indicator (KRI)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Liquidity risk	Liquidity of assets	Transaction volume trend Average transaction size Marketing period trend	Decrease in liquidity of the asset	At acquisition: liquidity of assets to be analysed by transaction team and reported in 'investment committee' paper During holding and disposal phase: liquidity of assets to be monitored by asset/portfolio manager and reported to fund manager	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding and disposal phase: obtain and review asset/portfolio manager report
	External financing	External financing maturities	Inability to refinance within external financing maturities	At acquisition: external financing/covenants/hedging to be structured by transaction team in line with investment strategy and reported in 'investment committee' paper During holding phase: fund controller to monitor external financing/covenants/hedging and report to fund manager (including remediation actions)	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review fund controller report
		% borrowings hedged	Exposure to interest rate volatility due to low ratio of borrowings hedged on total borrowing		
	Breach of debt covenants	LTV	Breach in LTV ratio		
		DSCR (NOI/debt service)	Breach in DSCR		
		ICR (EBIT/interest expense)	Breach in ICR		

Risk category	Risk	Key risk indicator (KRI)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Business risk	Asset level rent data (micro-economic risk)	% Occupancy	Decrease in occupancy of the property based on rents or total leasable area	At acquisition: asset level rent data to be analysed by transaction team to check alignment with investment strategy and reported in 'investment committee' paper During holding phase: asset manager to monitor asset level rent data and issue 'asset level' report to fund manager (including remediation actions)	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review 'asset level report'
		WALB and over/under-rented assets	Decrease of WALB Increase in over-rented assets		
		% lease breaks < 2 years	Increase of % leases with break within 2 years' time		
		Location of the asset	Decrease in the 'prime' attributes of a location (CBD, decentralised, peripheral)		
	Obsolescence	General condition of the building with respect to sustainability and social sustainability (green certifications, etc.)	General condition of the building is poor or is deteriorating	At acquisition: perform technical and environmental due diligence (DD) During holding phase: asset manager/property manager to monitor maintenance program, follow-up on DD items and issue 'technical status report'	At acquisition: ensure technical due diligence is properly performed During holding and disposal phase: obtain and review 'technical status report'
	Development risk (as the case may be)	% Pre-let	% vacancy and associated costs	At the outset: determine minimum % pre-let before starting construction During construction: fund manager or asset manager to monitor letting process	Obtain and review status report
		Retention of planning/ building permit (as the case may be)	Delays in the administrative process to get authorisations or changes resulting from the administrative process	Fund manager or asset manager to monitor preliminary studies and administrative process; assess impact on performance (e.g. IRR)	Obtain and review status report
		Cost overruns and delays in construction	Non-compliance with initial budget and delivery date due to variations, mismanagement and unforeseen events during construction	At the outset: technical specifications to be determined under the control of fund manager or asset manager During construction: fund manager or asset manager to monitor construction progress; assess impact on performance (e.g. IRR)	At the outset: ensure specifications are available During construction: obtain and review status report
		Credit rating of developer/ contractor	Default of developer/contractor during the development or construction process	At the outset: fund manager to perform financial due diligence During construction: fund manager to monitor counterparty solvency	At the outset: ensure financial due diligence is properly performed and adequate legal documentation is in place During process: obtain and review status report

Risk category	Risk	Key risk indicator (KRI)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Operational risk	Poor asset and property management	Quality of reporting, compliance with instructions and deadlines	Poor asset/property management (company risk and people risk)	Fund manager to ensure that asset/property manager has proper and sufficient resources in place to manage the asset (ongoing oversight)	Discuss, document and track dialogue with fund manager on this topic
	Poor financial, legal, tax, environmental and technical due diligence	Due diligence (DD) findings, follow-up and monitoring of changes Due diligence costs	Comprehensive initial DD report and subsequent changes in related matters Dead deal costs	At acquisition: financial, legal, tax, environmental and technical due diligences to be performed by service providers During holding phase: fund manager to follow-up on initial DD findings; fund manager to monitor legal, tax and regulatory changes	At acquisition: obtain and review DD reports (ensure DDs are properly performed) During holding phase: obtain and review fund manager report
	Contractual obligations resulting from disposal	Disposal documentation	Guarantees or commitments issued in the disposal documentation	Fund manager to ensure proper assessment of guarantees and commitments issued in the disposal documentation	At disposal: review, comment and sign off the 'disposal committee' paper prior to final transaction approval
Valuation risk	Market value mis-statements	Independence and competence of the external appraiser	Issues noted with the independence and competence of the external appraiser	At acquisition and during holding phase: documented, transparent and independent valuation review process to be implemented by AIFM	At acquisition and during holding phase: * Check independence and competence of external appraiser * Check compliance of appointment procedures * Appropriate involvement and oversight in valuation review process
		Compliance of external appraiser appointment	Issues noted regarding compliance of the external appraiser appointment process (accordance with professional standards and industry practices)		
		Conclusions of independent valuation review process	Issues noted in the conclusions of the independent valuation review process (review of the valuation model and underlying assumptions used by the external appraiser)		

Fund level risks

Risk category	Risks	Key risk indicators (KRIs)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Market risk	Geographical concentration	% market value per country/city	Increase of fund level exposure to a given country/city	Fund manager to monitor and report on country/ city concentration and on currency risk	At acquisition: check currency hedging arrangements During holding phase: obtain and review report
	Macro-economic risk	Currency	Foreign exchange issues resulting from currency fluctuations in countries in which the fund is invested		
Credit risk/ counterparty risk	Inability to drawdown uncalled commitments	Credit quality of investors	Decrease of the credit quality of investors (if credit rating not available, use alternative assessment)	Discuss, document and track dialogue (i.e. decrease in credit quality temporarily acceptable, initiatives taken to closely monitor investor solvency, etc.)	Review process (e.g. methodology to determine investor solvency, use of several independent sources of information)
	Tenants' concentration	% income per tenant	Increase of fund level exposure to a given tenant	Asset manager to monitor tenant/industry/financial institution concentration and issue 'asset level report' to fund manager	At acquisition: check impact of acquisition on fund concentration ratios During holding phase: obtain and review 'asset level report'
	Industry concentration	% income per industry	Increase of fund level exposure to a given industry sector		
	Financial institution concentration	% exposure per financial institution e.g. on cash, loans, derivatives	Increase of fund level exposure to a given financial institution		
Operational risk (governance)	Non-compliance with anti-money laundering, (tax) laws and regulations, governance	Non-compliance with AML procedures, fund (tax) law and regulations, governance	Issues identified in AML procedures or breach in (tax) laws and regulations, e.g. transfer pricing, leverage ratio under gross and commitment method	Discuss, document and track dialogue (i.e. action plan to become compliant, replacement of external service provider, etc.)	During acquisition, holding and disposal: obtain and review control reports; monitor implementation of remediation action plan
	Wrong or ineffective operational processes such as oversight on external service providers or internal controls	Reporting delays, # incidents per reporting period	Non-compliance with operational processes		
	Breach of investment restrictions	Investment restrictions as defined in legal fund documentation	Breach in investment restrictions foreseen in legal fund documentation	At acquisition: portfolio manager to check alignment with investment restrictions During holding phase: fund controller to monitor investment restrictions and report to fund manager (including remediation actions) At disposal: fund controller to report status of investment restrictions to fund manager	At acquisition: check alignment with investment restrictions During holding and disposal phase: obtain and review fund controller report

Risk category	Risks	Key risk indicators (KRIs)	Risk description/ explanation	Expected controls/processes	Checks to be performed by the AIFM RM
Liquidity risk	Inability to meet investor redemption requests	Liquidity stress test conclusions Impact of investor profiles	Decrease in liquidity of assets resulting in difficulties to dispose the asset in view of meeting investor redemption notices Frequency of investor redemption requests, e.g. from FoFs, might tendentiously be higher compared to redemption requests from pension fund investors	At acquisition: *Liquidity of assets to be analysed by transaction team and reported in 'investment committee' paper *Fund investor profiles to be analysed and reported by fund manager (redemption control process in place for open-ended funds) *Liquidity stress test to be initiated by fund manager (estimation of redemption requests and fresh money, e.g. via new investors) During holding and disposal phase: *Liquidity of assets to be monitored by asset/ portfolio manager and reported to fund manager *Changes in allocation of fund investor profile monitored and reported by fund manager (redemption control process in place for open-ended funds) *Liquidity stress test to be initiated by fund manager (estimation of redemption requests and fresh money, e.g. via new investors)	At acquisition: *Review, comment and sign off the 'investment committee' paper prior to transaction approval *Review and comment on fund investor profile and on liquidity stress test During holding and disposal phase: *Obtain and review asset/portfolio manager report *Review and comment on fund investor profile and on liquidity stress test
	External financing	Pledge of assets	Cross-collateralisation of assets	At acquisition: external financing guarantees to be structured by transaction team and reported in 'investment committee' paper During holding phase: fund controller to monitor status of issued guarantees and report to fund manager (including remediation actions) At disposal: external financing guarantees to be restructured by transaction team and reported in 'investment committee' paper	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review fund controller report At disposal: review, comment and sign off the 'investment committee' paper prior to transaction approval
		Cluster risks	Expiry of leases, maturity of loans at the same time	At acquisition: expiry of leases and maturity of loans to be structured by transaction team and reported in 'investment committee' paper During holding phase: fund controller to monitor status of expiry of leases and maturity of loans and report to fund manager (including remediation)	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review fund controller report
	Financial structuring	Cash out restrictions	Structuring and external finance covenants limiting cash distributions from SPVs (cash traps)	At acquisition: fund controller to report restrictions in 'investment committee' paper During holding phase: fund controller to monitor cash out processes	At acquisition: review, comment and sign off the 'investment committee' paper prior to transaction approval During holding phase: obtain and review fund controller report
Strategy risk	Alignment of performance with the business plan of the fund	Business plan of the fund, cash-on-cash yield, IRR computation	Inability for the fund to meet its financial targets	Performance measurement to be assessed by portfolio manager to check alignment with investment strategy and reported in 'investment committee' paper (including remediation actions during holding phase)	At acquisition, during holding phase and at disposal: review reasonability of assumptions underlying performance calculation as stated in 'investment committee' paper

Appendix B: Glossary

AIF means any collective investment undertaking (including investment compartments thereof) that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which does not require authorisation pursuant to the UCITS Directive (undertakings for collective investment in transferable securities – Directive 2009/65/EC).

AIFM means an alternative investment fund manager as defined in article 1(46) of the AIFMD.

AIFMD means Directive 2011/61/EU of 8 June 2011 of the European Parliament and of the Council on alternative investment fund managers as amended from time to time (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF).

Counterparty risk means the risk of loss resulting from a counterparty to a transaction defaulting on its contractual obligations prior to the final settlement of the transaction (replacement risk).

Concentration risk means the risk of adverse effects on the value of the portfolio of an AIF arising from lack of diversification/large position in a single asset or market exposure.

Delegated Regulations means Delegated Regulations (EU) no 231/2013 of 19 December 2012 of the European Commission supplementing the AIFMD with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (known as Level II).

External appraiser refers to the third party independent appraiser performing the valuation irrespective of whether or not the external valuer role has been accepted as per article 19 of AIFMD.

INREV means the European Association for Investors in Non-Listed Real Estate Vehicles (www.inrev.org).

Investment advisor advises the AIFM portfolio management function regarding (dis)investments of assets of an AIF. Investment advisors do not make investment decisions. The responsibility for investment decisions lies with the AIFM portfolio management function.

KPI means key performance indicator.

KRI means key risk indicator.

Liquidity risk means the risk of the fund (in case of liquidity needs) not being able to liquidate its investments in a timely and cost-effective manner.

LTV means loan-to-value.

Market risk means the risk of a negative impact on the value of property as a result of changes in macro-economic and micro-economic factors as well as in capital markets.

Operational risk means the risk of loss resulting from inadequate processes and failures in relation to people and systems of the various service providers to the AIF or from external events, including legal and documentation risk (as such, it covers the risk resulting from the transaction, settlement and valuation procedures operated on behalf of the AIF).

WALB means weighted average lease period until the first break option.

Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 125,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our professionals are involved the same standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

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