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Investment discipline key to future fundraising success

Managers who sold at the height of the market will be rewarded for their 'discipline' when LPs once again start deploying capital to private equity real estate vehicles.

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Managers who refused to "blindly" pursue investment strategies and sold assets at the height of the market will be the ones rewarded with new commitments in the next fundraising cycle.

Challenging comments that managers shouldn't be blamed for poor performance if they stuck to their strategies, pension fund advisor Ted Leary argued fund managers would be judged in the future for their "willingness or unwillingness" to deploy investor capital when markets had "changed for the worse".

The founder of Los Angeles-based advisory firm Crosswater Realty Advisors said markets mattered, adding: "One particular complaint that comes up over and over again is managers who pumped the money out at the height of the market. Yes, admittedly that involves 20-20 hindsight, but not all managers did that."

> **"Managers are not supposed to blindly pursue strategies established months and even years ago."**
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> *Ted Leary, Crosswater Realty Advisors*

Leary, who is advising several large US public pensions, said as LPs reviewed existing fund investments it was becoming evident some GPs did heed the warning signs of a overheated market. "Managers are not supposed to blindly pursue strategies established months and even years ago. They should constantly double check those strategies against changes in the market and make strategy changes – including ceasing investing if needed."

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>
> *Leary*

Leary added: "Fair or not, the conclusion investors often arrive at is that the more aggressive managers were driven by a short term fee mentality, rather than the long term interests of their clients."

During a recent PERE European Roundtable debate, Brendan O'Regan, senior property manager at Ireland's National Treasury Management Agency, argued that if managers had adhered to the fund strategy that was articulated to investors when they entered the fund – and deployed capital in line with that strategy – there shouldn't be a rush to criticise performance owing purely to market events.

Instead, O'Regan stressed blame should be levelled at GPs who deviated away from an agreed strategy and where a GP's own behaviour had contributed to declining fund performance. Investors, he said, should not be critical of a strategy that just "didn't work out". What mattered now, O'Regan said, was how managers behaved next.

The issue of performance has generated heated debate at property conferences globally, with delegates at the USA GRI 2010 event last week hearing that character – not just performance – should be the driving factor behind GP selection in coming years.

Speaking at the forum, a group of property advisors said LPs would be looking at the behaviour and character of GPs during the recession – and how they handled investor communications – rather than just performance as a means of assessing future fund commitments.

John Baczewski, president of Ipswich, Massachusetts-based advisory firm Real Estate Fiduciary Services, told PERE at the event: "Performance is no longer a differentiator [among GPs]. It's how you responded to the difficult markets, it's how you handled communicating those difficulties with your investors – it's all about trust. If GPs want to survive, they are not only going to have to have a good investment thesis going forward but they are also going to have had to pass the character test," he added.

Have your say on the factors that will drive fund manager selection in the coming years by emailing zoe.h@peimedia.com