

Independent voices

Many major public firms have independent directors on their investment committees to meet governance standards and help provide perspective. So why hasn't the private real estate sector yet caught on? **By James Comtois**



There may be no research to suggest that having independent directors on the investment committee is a sure fire way to improve IRRs. Nevertheless, there is a notable body of opinion in US private equity real estate suggesting that indies should have a greater role to play in the industry. Indeed, representatives from CBRE Global Investors and Bentall Kennedy recently espoused the value of such a trend at

the PERE Summit in New York last month.

So far, the practice of using independent directors within a real estate investment firm's or institutional investor's investment board or committee is not widespread and while pockets of examples do exist, it is nowhere near as developed as in the public sector.

After all, having independent directors is an accepted best practice in many, if not most, major public firms. A number of public firms have realised the advantages to having independent members on whichever committee makes the investment decisions.

The advantages to private equity real estate firms are both myriad and self-evident. First and foremost, the practice helps mitigate risk, particularly any risk connected to 'deal fever' or cronyism. In addition, independent directors can hinder employee directors from solely acting in their own best interests.

Furthermore, an outside member of the investment committee can help prevent 'groupthink' and can foster healthy debate. For emerging fund managers, having an independent board member with a wealth of industry experience - a retired investment executive, for example - can help lend credence and credibility to a first-time fund.

Not only that, but an independent director can provide fresh eyes that can help the firm cast a wider net when it comes to seeking and selecting investment opportunities.

Yet aside from a handful of real estate companies, this practice of bringing independent members onto a private real estate firm's investment board or committee has yet to catch on in the sector in any meaningful way. Why is this?

Some believe that the industry hasn't embraced this governance practice simply because the big players in the business haven't yet pushed the matter or endorsed the policy, and until that happens, the implementation of independent directors or board members will never be the industry standard.

There are also those within the industry that have pushed back at the idea of a need for independent voices on firms' or institutional investors' investment boards by using the

(rather diffident) arguments, 'one size doesn't fit all', and 'an independent director is not synonymous with best practices'.

There's also a matter of pride that's at play in some firms and institutions. In short, a number of GPs don't like being told how to invest their capital by an outsider.

Still, a few members of the industry have become believers in the cause. Ted Leary, founder and president of the Los Angeles-based advisory firm Crosswater Realty Advisors, has been a very vocal advocate for the practice. He said: "Firms that have good governance structures, which includes having independent directors, tend to make better decisions."

A few real estate investment firms here and there are speaking out in favour of the practice too. At a discussion panel on governance and reporting at the PERE Summit, Peter DiCorpo, president of CBRE Global Investors' US managed accounts group, endorsed the policy, as did Bentall Kennedy US's chief executive officer Michael McKee.

"We are deep believers in it," said McKee at the Summit. "We believe it brings an internal accountability that this industry needs."

"Our independent director has really changed the course of the way our investment committee thinks and acts," added DiCorpo, pointing out that CBRE's director isn't afraid to speak his mind both on the positive or negative aspects of a deal or vote no on a deal.

In addition, the wealth management firm Quilvest has had external members on its real estate investment committee since 2008. At Quilvest, these independent investment committee members have a voice on every deal discussion and a vote on every potential investment for its real estate platform.

Ultimately, it's always a good idea to give an impartial person who can bring a broader perspective to the table a vote as to where to invest. In particular, it isn't a bad idea for a GP or LP to bring on board someone who isn't going to get a bonus based on whatever deal he or she proposes.

On the subject of independent directors being widely used within the private real estate segment, Leary said that he sometimes feels "like Don Quixote tilting at governance windmills". Perhaps if more real estate GPs such as CBRE, Bentall Kennedy and Quilvest joined Leary's quest, more firms will follow suit, rendering said quest less quixotic.

It could be even more effective and less quixotic still, however, if more of the largest fund managers and pension plans that invested in real estate championed the implementation of independent investment advisors or board directors. If and when that happens, the practice could become more commonplace within the industry. And that is a practice that those in the industry might get behind. □