

Partner Diagnostic Review and Deep Dive

Purpose

The process of evaluating real estate operating companies and investment managers (herein both referred to as “partner(s)”) for future allocations requires investors to extrapolate, from past results, the future performance of partners. It is Crosswater’s experience that comfort in future partner performance cannot be derived solely from historical results. Historical results are highly dependent on investments’ vintage year and exit year, and where these are relative to the overarching market cycle. The limitation of past results is especially true for high value-add and opportunistic funds, which are more often subject to “rude surprises” in their portfolios as they target heterogeneous, complex investments across strategies, product types and geographies.

Real estate investment success is highly dependent on the quality of the systems, discipline and personnel of the partner. An investor must first be comfortable with a partner’s organizational strength and longevity before it can be comfortable using its track record as an indicator of future performance.

Crosswater utilizes a two-part approach to evaluating opportunistic partners—the “Diagnostic Review” and “Deep Dive”. These two elements go beyond the numbers to underwrite the methodology, processes, organizational stability and culture of a partner. We focus on risk identification, assessment and mitigation during the underwriting and investment process across all stages of the fund cycle. Finally, we evaluate a partner’s “Institutional Memory” and how effectively it is captured and communicated to junior staff to ensure past mistakes are not duplicated and lessons are internalized. We believe that, if a partner has adopted a set of robust processes and methodologies for investing capital and managing assets, and ensuring that it acts with its investors’ best interest in mind, then it is possible to get comfortable (or uncomfortable in the absence of such processes) with a partner’s expectations for future performance.

Process

The Diagnostic Review and Deep Dive is a 3-4 day intensive onsite interview of a partner’s senior, mid-level, and select junior-level staff across acquisitions, asset management, finance and reporting, compliance, and other functions. The review evaluates a partner’s processes and methodologies for investing capital, mitigating risk, managing assets, and monitoring and reporting performance to limited partners. Crosswater also reviews the partner’s staffing, organization, business culture and fiduciary practices. The Diagnostic Review covers the following areas, among others:

Investment and Asset Management

- Business and Strategic Planning
- Investment Sourcing and Screening
- Local Partner/Operator Vetting
- Investment Underwriting and Risk Mitigation
- Investment Committee Composition and Processes
- Asset Management Operations and Execution
- Governance and Compliance
- Asset-level Monitoring and Reporting
- Valuations and Reporting to Limited Partners
- Exit Strategy and Process

Alignment of Interest

- Compensation Composition and Structure
- Management and Incentive Fees
- Fiduciary vs. "Deal Shop" Mindset

Organizational Culture

- Systems for Transmitting "Institutional Memory"
- Quality of Personnel (Senior- to Junior-level Professionals)
- Professional Staff Teamwork and Culture

The Deep Dive is an in-depth analysis on 5-7 assets that are selected by Crosswater to form a representative sample of the partner's portfolio by investment size, product type, geography, position in the capital stack and acquisition and asset management teams. Crosswater reviews investment and due diligence materials and interviews (without the partner's senior executives being present) acquisition and asset management teams for each asset to assess the quality of personnel, the extent of investment underwriting and risk mitigation, and the overall consistency of performance from underwriting to actual results.

The Deep Dive helps give comfort to the current projected unrealized returns at both the asset level and at the portfolio level by:

- Reviewing the sample transactions' performance to-date
- Evaluating how consistently and thoroughly investment methodologies and processes are understood and applied across investments, geographies and teams
- Identifying the critical variables and key assumptions most likely to affect whether select assets meet return projections and tracking actual performance against these variables/assumptions across the sample investments



The Crosswater Difference

The nature of high value-add and opportunistic strategies means partners are susceptible to performance volatility despite their best efforts. An investor must be comfortable that a partner has developed and will consistently implement, a set of robust processes and a disciplined approach to investing capital, managing assets, conducting valuations and reporting results across investments and funds to ensure that rude surprises are minimized and the partner's fiduciary obligation to its investors remains paramount. Crosswater's partner review goes beyond the numbers to allow investors to gain this comfort.

Crosswater's independent, unconflicted perspective and 35+ years of experience in real estate - as investment managers and restructuring specialists - in all product types and across multiple cycles, make us uniquely qualified to identify the qualities of a partner that are necessary to achieve persistency of returns over time and across funds.

While predicting the future with total certainty is an impossible task, firms with proven discipline are more likely to achieve their stated goals than others. As long time investors and workout specialists, we know when performance is the result of providence rather than prudence. We know the organizational qualities and structures that drive continued, sustainable investment success and understand that the optimal way to avoid future problems is to properly underwrite a partner's skills before a single dollar is invested.