

Real Estate Asset Managers Criteria Report

Reviewing and Rating Real Estate Asset Managers

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Related Research

- [Reviewing and Rating Asset Managers \(June 2009\)](#)
- [Open Ended Real Estate Funds - Challenges for Liquidity Management \(June 2008\)](#)

Summary

- This report sets out Fitch Ratings' methodology for rating real estate asset managers. The approach is founded on the general framework used by the agency to rate asset managers in various contexts (fixed income, equity, balanced, fund of hedge funds, and so on) while also incorporating factors that reflect the specifics of real estate asset management resulting from their heavy focus on due diligence conducted for the selection of less liquid assets.
- Fitch has unified its ratings scale for Asset Manager Ratings. All asset managers will now be rated on a scale of 'M1' to 'M5', with 'M1' indicating the highest rating. This unified scale emphasises the common general framework and creates greater consistency and comparability across the range of rated asset managers and underlying investment approaches.
- As with all its ratings on asset managers, Fitch issues Asset Manager Ratings for real estate asset managers to provide investors with an independent assessment of an asset management organisation's investment management capacity and vulnerability to operational and investment management failures. While this assessment includes considerations on the current financial standing and near-term sustainability of rated asset managers, Asset Manager Ratings are not an explicit evaluation of their financial condition and should not be confused with Fitch's credit ratings.
- Fitch's Asset Manager Rating methodology, which was first developed in 1998, is designed to systematically capture, evaluate and report on an asset manager's key characteristics via a multi-faceted approach, which provides for the aggregation of the rating factors into five distinct groupings. This allows Fitch to achieve focused analysis, to clearly express rating conclusions and to profile rated asset managers. Qualitative inputs from analysts also serve as the defining input in the assignment of the final ratings, allowing for the consideration of individual asset managers' circumstances. The categories reviewed in the context of real estate asset managers are as follows:
 - Company and staffing;
 - Risk management and controls;
 - Investment selection;
 - Portfolio management; and
 - Investment administration.
- Fitch's Asset Manager Ratings are announced via rating action commentaries and followed by rating reports published on the agency's website at www.fitchratings.com. All Asset Manager Ratings are updated at least annually; in the interim, these ratings are subject to ongoing monitoring and rating actions may be taken if deemed necessary by Fitch.
- The Real Estate Asset Manager Rating may be accompanied by a rating of individual real estate funds under management (Fitch's Real Estate Portfolio Score - see methodology on the agency's web site).

Introduction

As the global real estate markets continue to develop the opportunities to invest in real estate across markets are increasing. Institutional investors - particularly those that have a long-term investment horizon and seek to match their long-term liabilities - have increasingly come to regard real estate as an integral part of their investment allocation strategies.

Concurrently, a growing number of investment management firms, large and small, have entered this specialised segment of the industry, offering a variety of real-estate-related investment products, usually in the form of closed- or open-ended funds and separately managed accounts.

Depending on their business model and investment products, real estate asset managers may perform just one, a combination, or all of the following services:

- strategic research of properties and markets;
- development of investment management strategies;
- identification of investment opportunities:- acquisitions - targeting/sourcing deals;
- performance of property/asset due diligence
- completion of the acquisition and/or loan transaction;
- property/asset management: overseeing the leasing, financing, maintenance and renovation of properties;
- execution of property/asset disposals.

Their investment offerings generally fall into three broad categories: core, value added and opportunistic strategies. Although not strictly defined by their risk/return profiles, such strategies or funds are mainly differentiated by the level of leverage used and the strategic holding periods of the underlying investments.

Generally, core funds have a conservative risk/return profile, involving little leverage and long holding periods for property investments with very moderate portfolio turnover. Such funds emphasise income generation rather than capital appreciation.

Value-added funds entail a moderate risk/moderate return style with leverage of close to 50%, shorter holding periods and higher portfolio turnover than the core funds.

Finally, the opportunistic style refers to products offerings with a high risk/return profile, leverage above 70% and high turnover, which seek shorter-term capital appreciation in the property investments.

Real Estate Investments

- | | |
|---|--|
| • Direct investments in properties | ○ Core properties |
| | ○ Development/redevelopment properties |
| | ○ Distressed properties |
| • Whole mortgages | |
| • Mezzanine debt | |
| • Structured debt investments (CMBS) | |
| • Public securities | ○ REITs (Equity, mortgage, hybrid, private) |
| | ○ REOCs |
| | ○ Publicly listed property unit trusts - in select international markets |
| • Private equity investments | |
| • Partnerships or limited liability corporations focused on one or more investment vehicles and/or property types noted above | |
| • Various exclusive investment structures | |

Source: Fitch

Separately managed accounts can offer these generic strategies or may be more specialised by property type, geography or specific investment vehicle (eg real estate investment trusts or REITS). Some may focus exclusively on direct property investments.

Irrespective of whether real estate asset managers are making direct property investments or investing in real estate-related instruments, a specialised manager assessment framework is needed to identify the managers that possess the requisite specialised capabilities and offer a suitable match for specific real estate investment mandates.

Asset Manager Rating Scale

Under the unified rating scale, definitions have also been amended to more accurately reflect the meaning, and therefore limitations, of the rating (see *Appendix 2*). Asset Manager Ratings constitute an assessment of an asset management organisation's vulnerability to operational and investment management failures. Such failures can take the form of mismanaged risk budget, excessive counterparty risk taking, fund closure and/or fire sale due to miscalibrated liquidity or asset liability risks, miscommunication or business disruption, among others.

The ratings are issued on a five-tier scale of ('M1' - 'M5'), with 'M1' being the highest rating, denoting the lowest vulnerability to operational and investment management failures while 'M5' is assigned to managers demonstrating material vulnerability to such failures.

Ratings Criteria Overview

As noted previously, Fitch has adapted its manager rating methodology to suit the unique aspects of real estate asset management. The following sections therefore describe the areas of focus for each of the five categories of ratings analysis, placing particular emphasis on the factors and considerations specific to Fitch's real estate asset manager scorecard.

As a company's financial standing is a decisive factor in its ability to ensure business sustainability, an asset manager's overall rating may be capped by its score in the shareholding and financial standing sub-category, should the financial condition of the rated manager or its parent company be of concern to Fitch's analysts. The agency is working closely with its Financial Institutions group to update its financial analysis of asset managers and refine the relationship with the overall Asset Manager Rating. It should be noted, however, that in the context of a manager rating, financial condition is not assessed with the same perspective as that of a credit rating. Although a credit rating gives a good indication of the financial condition of a company, it is important to bear in mind that debt-holders and counterparties - excluding fund investors - may well suffer economic losses, whose likelihood is measured by credit rating measures, while the company may still remain viable and continue to perform its asset management duties in the best interests of investors.

Fitch recognises that, due to differences between asset management organisations in terms of attributes such as size, geographic coverage, asset classes covered, client types, operating strategy and assets under management, the application of the rating criteria requires careful consideration of the context in which they are applied.

Company and Staffing

This category of factors assesses the firm's status in terms of its financial condition and business prospects, the level of independence with which investment management decisions are undertaken, and the depth and quality of staffing resources. It encompasses executive and investment management, and risk functions as well as supporting staff in various administrative functions.

The evaluation process begins with a thorough investigation of the organisation's history, current situation and future plans to identify an appropriate peer group and, more specifically, to identify the appropriate comparables for the ratings analysis. Fitch considers the organisation's experience as a real estate asset management company, incorporating factors such as years of business history, stability of ownership structure, primary business strategy, and organisational structure to assess the quality of the match between organisational structure and its targeted business and real estate management objectives. The agency takes into account the diversification of the company's business, the sources and means of financing, the range of representative investors, the company's market share and its long-term growth potential. Fitch's assessment recognises that real estate markets in different jurisdictions are at differing stages of maturity and that a large number of asset managers have only limited tenure.

In evaluating the organisation's financial standing, the primary objective is to assess its working capital requirements and resources. Fitch stress-tests the organisation's financial drivers to measure the manager's capacity to maintain its operations over a reasonably long period of negative cash flows. This aspect has become increasingly important as this business, generally long-term in nature, can be affected by external shocks and adverse business flows like those experienced by the German market for open real estate funds in 2005 and most of 2006. In that case large redemptions not only led to notably lower asset bases in some cases, but were also accompanied by forced sales of properties.

Fitch assesses both the organisation's financial strength and the regulatory authorities' recognition of the shareholders. It also evaluates the shareholder's commitment to real estate asset management based on the financial and operational support provided to these activities. Where available, the credit rating is used to gauge the organisation's financial condition, or that of its parent company. For unrated entities, Fitch reviews the organisation's financial statements from the preceding three years, particularly focusing on liquidity, profitability and capitalisation. Financial strength is vital in this industry, as various degrees of financial leverage and various types of collateral are an inherent part of financing real estate asset management activities. As recent examples have shown - in the German market, for example - liquidity can become unexpectedly problematic for open-ended funds where the fund's rapid access to short-term borrowing and drawing lines can be quite important.

Fitch considers several aspects of the company's balance sheet and income statement to ensure that capital allocations are consistent with the risks inherent to this business: revenue and expense trends, income volatility, concentrations by client and product, product mix and stability of assets under management.

The agency determines the manager's independence from its shareholders' other activities and from other parties. Well-maintained independence is likely to prevent any conflict of interest in advising or working for a client. Fitch evaluates the degree of corporate independence and supervision, as evidenced by the extent of the activities conducted with group affiliates. The factors considered are the sales activities of the relevant real estate instruments/vehicles, and, more particularly, the internal transfer of properties within the group, or internal real estate tenancy by group entities. This also includes lending activities between the two. Fitch will, in addition, examine the quality of firewalls, procedural protection and compliance monitoring practices, especially with respect to the level of capital and financing conditions.

When examining good governance practices, Fitch assesses the existence of independent members on the boards of the funds and the company. The independence of non-executive board members will be assessed primarily in light of their experience and links, if any, with the organisation. Fitch also examines the

asset manager's operational independence in terms of resources (research, control, marketing or sales teams), a clear separation of operations being preferable.

Fitch's assessment of staffing resources is not geared towards attempting to quantify "skill" and "talent" but instead focuses on objective measures evidenced through a study of the backgrounds of management and staff, both individually and collectively. It focuses in particular on the specialised skills and experience needed in the relevant phases of real estate asset management, which vary depending on the type of real-estate-related investment products under management. As the aim is to evaluate the quality, stability, depth and experience of staff, Fitch specifically seeks to assess the amount of relevant experience and previous track records of both senior management and portfolio management staff. Similarly, staffing resources are assessed for each core functional group within the organisation.

Depending on the organisational structure and the manner in which duties are distributed among team members (research, third party and property due diligence, investment selection, portfolio management, and operations, among other responsibilities), individual workloads (eg the number of countries, properties, tenants or leases per responsible manager) will be used to assess the adequacy of staffing resources. This will include consideration of the volume and type of assets under management, the investment strategies applied, and the number of properties or sectors covered within a given portfolio, as well as overall assets under management. It will also take into account the extent of outsourcing (property manager, investment partners) and the surveillance thereof.

In addition, staff turnover is reviewed to determine staffing stability, with particular focus on the investment team, at the level of both acquisition and property management, since this can be a key determinant of continuity in investment process through time. However, as with all areas of assessment in the scorecard, change is not penalised when where it occurs in positive circumstances and clearly improves the organisation's capabilities.

Risk Management and Controls

In this area, Fitch assesses the organisation's compliance with fundamental aspects of risk management: knowledge of its risks, the monitoring of those risks, and the use this knowledge when making investment management decisions; Fitch considers the essential aspects that indicate the quality of the organisation's risk management practices. It also assesses the quality of the asset manager's internal controls and its independence through a review of documentation, control execution and reporting for relevant procedures.

Fitch acknowledges that there is no "one size fits all" risk management framework, as needs will vary greatly among different organisations depending on the type of real estate under management or the specific investment strategies used.

Although real estate assets are generally considered to be less volatile than other asset classes in a portfolio context, the associated risks in real estate asset management are not necessarily smaller or easier to manage. On the contrary the associated risks take a wide variety of different forms. These depend, among others, on the type of investment vehicle, as well as the way in which the investments are managed through the transition from the acquisition and development phase to the rental and maintenance phase. As time passes, the risk profile of a particular real estate investment can clearly change: for example investments in real estate development are critically dependent in their development phase on the quality of the selected providers, their financial standing and experience. In this phase, default, legal and litigation risks are particularly high although these risks may diminish once the building is completed. At that point, other risks related to aspects such as the maintenance and quality of the tenant structure, become more important and drive the cash flow generation of the property.

Such risks can generally be grouped into the following categories:

- Counterparty-related risks (credit, legal risks and quality of service provider);
- Macroeconomic risks (geography, common factors influencing the real estate cycle and property type);
- Property-specific risks (tenant, leases, vacancy, quality of the property, deal structuring and financing);
- Portfolio financing and liquidity risk (leverage, sales-/redemptions);
- Market risk arising from the financial portfolio (interest rate and credit risk);
- Company-specific risks (operational, processes and procedures);
- Concentration risk (lack of diversification).

Fitch assesses the overall risk management and control structure, the organisation of risk surveillance and the scope, experience and efficiency of the monitoring committees. The resources used to identify, manage and mitigate these risks are thoroughly examined. Risk identification and monitoring can take various forms depending on the organisation's size and its parent's requirements. Typically, larger real estate asset managers that are part of banking groups have developed thorough risk-mapping that covers numerous risk factors and multiple points of control, as well as systematic and in-depth monitoring and reporting procedures. In smaller organisations, the same degree of thoroughness can be achieved with less formalised processes, which nevertheless result in the involvement of qualified risk management personnel who deliver information and input as part of the supervision process.

Fitch reviews the compliance procedures, control points and reporting lines in place for managing conflicts of interest and meeting fiduciary responsibility. This includes checks on investment restrictions, anti-money-laundering procedures, and complaint management. A thorough control process should also be in place within the organisation to ensure that communication with and disclosure to clients is transparent, accurate, complete and understandable. Fitch evaluates the procedures in place, reviewing templates, investor reports, term sheets, newsletters and marketing materials.

The agency pays particular attention to valuation and pricing, which is of paramount importance in the real estate management industry as a whole, given the general absence of readily available mark-to-market prices or even reliable, market-representing and applicable benchmarks on pricing. Fitch reviews the valuation policies, focusing on independent decision-making, relevant methodology (comparables, income or discounted cash flows), data sources as well as data updating, and the day-to-day implications of controlling functions where particular situations arise.

Real estate management involves extensive relationships with third-party service providers such as developers, architects, construction companies, legal counsellors, valuation agents, and facility and property managers. Fitch reviews the policies and procedures in place for selecting and monitoring such third parties, and maintaining tight counterparty oversight. The aim is to ensure that relationships with real estate suppliers and financial intermediaries are based on unbiased criteria and established contracts, are formally monitored and the services rendered by these third parties continuously assessed by means of key performance indicators, tight communication and direct contact - underpinned by rigorous documentation. The agency's assessment also covers the credit risk management framework for monitoring these counterparties' financial strength.

Several property services that have important role and responsibilities in real estate management are typically outsourced (eg facility management, technical support). This poses unique challenges in terms of operational risk management, particularly

with respect to reputation. However, over-reliance on specific agents, fee concentration and lack of diversification lead to a natural conflict of interest - an aspect Fitch thoroughly assesses. Relationships with custodians and accountants, whether within or outside the group, must also be formally structured and monitored.

Fitch's analysis also reviews procedures and controls on investment risk management, with a particular focus on the surveillance and control of project and transaction monitoring. These, generally staged, phases entail substantial risks and typically, also, the payment of large sums. At the property level Fitch analyses the manager's capabilities in the area of lease management procedures and the controls in place to certify tenants' credit quality, and to ensure the correct and timely receipt of payments as well as the recovery of unpaid rents. The agency takes a positive view of managers that tightly monitor leases (length, structure and diversity, renewal and exit options for example) occupancy levels and vacancy rates where typically unexpected and high costs may arise when re-marketing the building and returning the occupancy rate to previous levels. Equally the monitoring of all property-specific measures - such as refurbishment, and its progress, timeliness and costs versus budgeted levels - are considered. This may well include the conduct and frequency of on-site reviews. Another area assessed is the asset manager's capacity to apply particular stress factors to the individual property as well as to the full portfolio.

Finally, liquidity monitoring is evaluated to capture the timely receipt and payment of all the portfolio's cash flows. Fitch emphasises the organisation's ability to manage cash buffers and back-drop lines to mitigate risks that can arise from both sources - internally within the fund's asset cash flows and externally through purchases and redemptions of participation shares.

Investment Selection

As real estate is typically a buy-and-hold investment, the investment selection decisions of the asset manager are among the primary determinants of portfolio performance. Every investment decision demands careful consideration, as real estate markets tend to be relatively illiquid, the price finding procedures are complex and lacking in transparency, and transaction fees are substantial. At the same time the acquisition process generally involves various specialised third-party provider.

Fitch reviews the related resources, methods, and tools used to carry out this very important phase of the investment management process. The review of this area is designed to determine the degree to which the organisation has a well defined, consistently implemented investment philosophy supported by research, active investment due diligence, and asset-level analysis.

Fitch seeks to understand the asset manager's core investment strengths, its strategy (income, capital appreciation, opportunistic buy and sell), its capacity for selection and the consistency of the investment style and convictions it has adopted. The agency reviews actual acquisitions and their foundation as part of how consistent they are with the company's strategic business plan. Whereas geography, property type and instrument are generally common drivers for achieving diversity in a real estate portfolio, particular challenges arise for the manager as the high value of the individual assets typically limits the number of properties that can be acquired, automatically leading to more concentrated portfolios. This requires a high level of discipline in the investment decision-making processes and Fitch assesses their variations over time. It also evaluates the overall means and procedures for investment selection and management, as well as their implementation and the extent to which they are properly formulated in terms of objectives, expected return targets, related risks and their drivers.

Strong research capabilities and good access to markets are important sources of added value for a real estate portfolio. Real estate can be both locally and globally driven. This criterion reflects heavily on an organisation's credibility with respect to its capacity to select and operate in its relevant domestic markets but, more particularly, its ability to gain meaningful access to foreign markets. Fitch distinguishes between strategic development, where a real estate manager commits its market research resources over the long term, and opportunistic involvement, where activity is based on less consistent research coverage and may only refer to one or a small number of acquisitions.

Fitch assesses the company's own research capabilities at both the macro and micro level, and the way in which it uses third-party research. This is important, given the relevance in this business of specialist knowledge and expertise about local market practices and players. In this area, the agency aims to measure the asset manager's capacity to identify investment opportunities in geographic areas, to evaluate the intra-market development of trends and prices, and to transform this analysis into risk-/ and return expectations. Of equal importance is the ability to pre-empt adverse market developments that may make asset disposal a prudent alternative. Fitch carefully studies the scope, quality and depth of the asset manager's research, and evaluates its track record for recommendations. In making its assessments, Fitch reviews the research documents produced by all the contributors to the investment selection processes (strategists, macroeconomists and research analysts) to assess their accuracy and timeliness. As reliable market data is often hard to obtain and comprehensive data bases tend to be the exception rather than the rule in real estate asset management, Fitch particularly studies the adaptation of indicators and methods used to evaluate market conditions. It reviews the relevance of the data used and the consistency of results achieved by conducting a reconciliation of estimates of future returns and real data; it also examines the frequency with which assumptions are updated. The agency's analysis also takes into account the manager's ability to perform stress tests at the macro level as an integral part of its decision-making process.

While such research can be considered to be the top-down element of an investment selection process, access to the relevant markets and desired property form the bottom-up component. Given the increasing competition between real estate market participants, access to market and, more particularly, individual property information has become of extreme importance. The size of the company, its financial resources, relationships and reputation critically determine its access and attractiveness to local agents, and ultimately its entry into the circle of potential bidders as the real estate manager becomes subject to a due diligence. This is clearly of particular importance when investing in foreign markets. Furthermore such standing is vital when seeking access to off-market deals in some markets.

Investment due diligence is an essential component of the acquisition process and, by extension, of the entire investment process. Therefore, the manager's acquisition due diligence practices merit particular focus. Procedures must be customised for each potential investment, defining and prioritising the analyses that are most likely to affect the investment decision for the particular property. Fundamentally, acquisition due diligence is the process whereby the investment manager confirms and justifies the selection of the property to be acquired and develops the investment strategy for it. The investment manager must also know how to perform, evaluate, articulate and integrate a high-quality, comprehensive due diligence process into the investment decision and into the investment strategy. It is vital for all relevant aspects - be they regulatory, tax, legal, technical or financial - to be comprehensively covered and for the property to match the manager's investment objective, adding value to the portfolio. This criterion additionally covers the capacity to value and price real estate by location, quality of construction, rental potential, maintenance costs and quality of tenants.

Price-finding procedures for real estate are complex and vary considerably depending on whether the property is non-occupied, fully occupied or in development. In addition, prices often include various contractual components such as free rental periods. The agency analyses the asset manager's due diligence process and the extent to which it is capable of determining a fair value for different locations, property types and occupation structures. It also challenges the results the asset manager obtained by applying different valuation methods.

Thereafter, the agency reviews the final stage of decision-making, assessing the asset manager's its formalisation and approval procedure, the parties involved and closing documentation.

Portfolio Management

The portfolio management score will be driven by factors affecting the following areas:

- investment/asset monitoring;
- property management;
- financial portfolio and liquidity management;
- investment/asset substitution and reinvestment;
- distressed investment/asset management.

An important aspect of Fitch's analysis of real estate asset management relates to each team's ability to shift focus and strategies in response to changing capital and real estate market conditions. It is important to understand that the investment management process must include regular hold-sell analysis.

Although real estate markets generally tend to move in long cycles, the current position in a particular cycle and market dynamics may not only differ from country to country, but may also vary within a single market or from one property type to another. Whereas some fundamental macroeconomic drivers such as economic growth, interest rates and inflation tend to influence all markets in the same way, micro factors such as development and demand dynamics can influence local markets significantly - as history shows. Moreover, real estate markets can display high volatility through shorter time horizons and may undergo periods of sharp decline in liquidity and, ultimately, value. It is also well recognised that different geographical markets have reached different states of maturity and, as a result, some may have only limited transaction volumes. It is therefore essential not only to understand the dynamics in the invested markets, the factors driving them and their different return contribution, but also to monitor them closely.

To assess the company's portfolio monitoring practices, the agency's review considers the procedures, tools and systems used, and their effectiveness in monitoring portfolio information in a meaningful way, in tracking asset-level performances and in monitoring and screening the markets. The frequency and level of monitoring will be evaluated to determine the degree to which it facilitates proactive portfolio management. The systems and tools used will be evaluated for their utility in providing relevant, timely information.

This monitoring naturally extends on a micro basis to the asset level, as there are particular drivers for each individual property type. The agency focuses particularly on the monitoring of the construction process, where the company must demonstrate its competence and expertise, documented through regular and frequent on-site visits as well as detailed documentation of the progress made.

In addition specific property-related issues may arise when monitoring leases, such as arrears or ultimately the default of an important tenant, as well as severe technical problems that require management's immediate attention. If the facility services are outsourced, Fitch evaluates the depth and frequency of communication with the third-party managers.

However, portfolio management in real estate firms does not only reflect monitoring capacities but also evaluates the manager's capacity to consistently seek measures to maintain or enhance value of the existing property. Fitch therefore reviews decision-making as it relates to efforts to add value to the property through appropriate actions such as refurbishment, the upgrade of tenant structure or facility improvements. The agency expects asset managers to conduct detailed long-term planning, involving assigned budgets, time lines and the allocation of adequate resources for monitoring compliance with plans. As property must be viewed in its individual as well as in its portfolio context, the agency reviews the tools and indicators used to analyse all property in a common framework that allows the asset manager to grade them by attractiveness, or sort them by certain ratios and assumed risks. While asset managers mainly concentrate on the acquisition process, Fitch additionally seeks to understand the overall asset disposal policy and discipline, its rationale and the driver for such decisions (strategic, market driven or cash-raising requirements) and considers the property turnover in the context of the asset manager's investment objectives. The agency also emphasises the manager's procedures for selecting suitable properties for sale within a fairly short time period if forced by market or the fund's liquidity position.

Finally, Fitch examines the management of liquidity, currencies and the portfolio's other financial assets. This covers not only dedicated responsibilities, but also the experience and professional background of the staff responsible, and the universe of financial instruments used. In addition, the agency considers the tools and systems for decision making, financial asset analysis and risk management, and elaborates on the portfolio manager's use of risk indicator and risk budget discipline. Particular emphasis is placed on the system's ability to view actual cash, as well as forward positions that reflect all relevant cash movements in the portfolio. Attention is also paid to how the real estate manager deals with the interest rate risk in leveraged portfolios and its capacity to make use of relevant financial instruments. Order-processing in active cash management is expected to be automated through approved financial intermediaries and well executed in terms of allocation, timing and fees.

Investment Administration

The varying mandates of the funds under management require asset managers to maintain defined portfolio management objectives while meeting specialised administrative, compliance, and reporting requirements. Fitch reviews the methods, systems, and controls surrounding the processes designed to ensure compliance with these requirements. Its assessment focuses on the following aspects:

- cash management;
- fund administration and accounting;
- investor reporting.

The asset manager's ability to effectively administer and manage its accounts is contingent on the quality of its processes and controls for directing, coordinating and overseeing the transactions affecting such accounts. Therefore, Fitch reviews the organisation's related procedures, such as account reconciliation, portfolio accounting and investor distributions. The company's processes for matching actual and expected cash receipts against actual and expected cash disbursements will also be an area of focus. In cases where certain administrative services are conducted by third party agents, the history and identity of the service provider coupled with the level of integration between the manager's processes and systems and those of the service provider will form the basis for evaluating the related investment administration functions. Operating procedures in this area also include communication with third-party service providers, particularly with respect to valuation and related middle- and back-office services related to transactions in the financial portfolio.

Client communication and reporting forms an integral part of investment administration. Fitch evaluates the organisation's capacity and willingness to offer a high degree of transparency in all its communication to investors (prospectus, fund reports, fact sheets, newsletters and marketing materials). The agency expects formal communication in the event of changes (to processes, portfolio managers or risk profile) and a production procedure that is independent of investment management. Modern communication typically entails internet access for both retail and institutional investors. Portfolio reporting will be a key area of focus, and Fitch does not only assess scope, coverage, frequency, timeliness and accuracy, but also reviews the full portfolio position disclosure for all property, including key data such as location, acquisition price, occupancy rate and implied leverage. Disclosure of the financial portfolio should also disclose risk parameters, such as the rating of money market counterparties and a comprehensive set of market risk indicators if the portfolio includes other financial instruments.

All reporting is expected to give a clear picture of the product's risk/return ratio, investment targets, strategy and management style, the fee structure and the basis for its calculation, as well as management's awareness of financial risks. It also includes a complete manager comment to offer investors a sound understanding of the performance achieved and the contributing factors.

Fitch examines the valuation process and procedure capacities, focusing on frequency, independence and accuracy. As the valuation of real estate is often less transparent than for other assets and results may differ depending on the methodology applied and the level of accepted deviation from fair value, asset managers are, as a minimum, expected to apply consistent fair value procedures. When valuation is outsourced to an administrator or valuation agent, Fitch not only seeks documentation of the relevant expertise and experience, but also reviews the asset management organisation's ability to offer interim or mirror valuations.

Technological resources and the systems that are central not only to administrative, but also to asset management functions are assessed. Fitch examines an inventory of these systems, which details their primary functionality as well as their coverage and automation. Fitch's ultimate aim in assessing the organisation's technology resources is to determine the match between the company's needs, as determined by its current and projected volumes (property, leases and number of tenants), and the level of complexity of asset types within its portfolios.

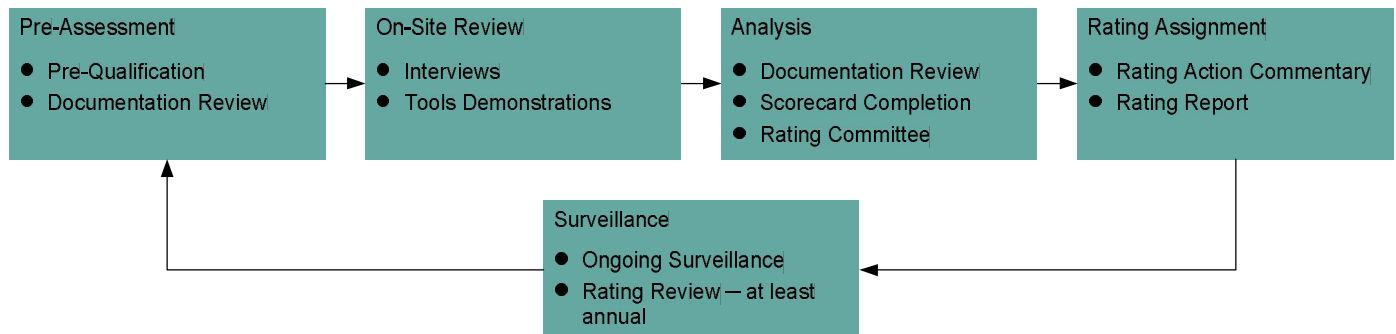
Beyond the quality of individual systems and databases, Fitch will also focus on the level of integration achieved between those components and external applications in order to achieve an acceptable level of efficiency, accuracy and, ultimately, scalability. Easy, secure and rapid access to data is becoming a competitive advantage. Data management and administration across the organisation will also be evaluated, with a particular focus on minimising operational risks while maximising efficiency. Sound financial valuation and simulation systems and tools that also provide cash flow modelling can be a real differentiator, particularly in real estate asset management.

Finally, Fitch evaluates the organisation's security, data back-up, retention and disaster recovery procedures. Risks of business disruption should be minimal particularly when such recovery procedures are tested on a regular basis.

Rating Process Overview

Fitch's Asset Manager Rating review process is designed to assess relevant information, consistently apply criteria and uniformly disclose the agency's rating rationale. The process incorporates five stages, as illustrated in the diagram below and described in the following section.

Rating Process Diagram



Source: Fitch

Pre-Assessment

Fitch utilises pre-assessment measures to determine whether it believes the asset manager can provide sufficient information on the following points to allow Fitch to proceed with the rating analysis:

- Can the asset manager demonstrate the sustainability of the investment services provided to investors, based on the following considerations: financial viability of the organisation; business model; asset- and product-related risks; experience of the organisation; level of external and internal oversight; and third-parties connectivity?
- Is the asset manager willing to disclose relevant non-public information to Fitch such as investment team background, research reports, meeting minutes, risk analysis and reports? It should be noted that the provision of non-public information to Fitch by the asset manager, as well as the use that Fitch may make of it, are covered by the agency's Code of Conduct and related policies, available at www.fitchratings.com.

In addition, prior to the on-site review, the asset manager being assessed is asked to provide a set of documents - as per the typical example in *Appendix 3* - designed to capture organisational, financial, operational and portfolio and personnel-related information. This information is reviewed to create a targeted agenda for the on-site review.

On-Site Review

The on-site review serves to assist Fitch in understanding the organisation's processes and controls.

It typically consists of interviews with executive management, the senior management of the different functional groups and their staff - typically in the areas of portfolio management, research, middle-office, back-office, IT, reporting, audit and risk control. In addition, the agency is given system demonstrations.

Analysis

Fitch uses an ordinal scoring approach to evaluate asset managers. This approach facilitates the consistent application of the methodology while minimising subjective variations in scoring qualitative characteristics. This is accomplished through the use of a scoring guide that defines all score levels for each factor within Fitch's analysis. Each factor is assigned a relative weight within the grouping of factors to generate group scores for all five main criteria, which are also assigned relative weights to determine the overall Asset Manager Rating, on a scale of 'M1' to 'M5', with 'M1' being the highest rating (see *Ratings Definitions* in *Appendix 2*).

Points awarded for most factors in Fitch's analysis are based on relative assessments considering standard and best practices, and comparison among rated asset managers. Some involve the awarding of points based on numerical measures or rank among peers, while others are based on the relative strength or merit of a quality or condition. The weighting of the factors represents Fitch's estimate of the relative importance of a factor within the related category based on the collective judgement of the agency's senior analysts. The factors, weightings and asset manager-specific analytical conclusions are aggregated by Fitch in an internal scorecard application. An abstract of this scorecard can be found in *Appendix 1*.

Together, the scorecards and scoring guides developed by Fitch serve as conceptual tools that ensure the consistent application of the rating methodology. However, like any tool with fixed parameters, scorecards are not perfect and Fitch does not, therefore, rely solely on a measurement on the scorecard; the circumstances of individual asset managers are also considered. Qualitative input from members of the rating committee will serve as the defining input in the assignment of the final ratings. Ultimately, rating decisions will be guided by the rating definitions in each of the five rating categories.

The rating committee, composed of on-site visit attendees and other senior analysts, validates the scorecard results and rating rationale, and determines the rating.

Ratings Assignment

Upon committee approval, the ratings will be issued via a rating action commentary - that includes the key elements of the rating rationale - followed by a rating report, all published on the agency website, www.fitchratings.com, which is freely available. The reports provide a profile of the company and personnel, processes, resources and operations and a summary of the scoring and rating rationale.

Surveillance

All Asset Manager Ratings are updated at least annually with ongoing monitoring and surveillance. Topics covered through this ongoing monitoring primarily include:

- corporate activity;
- staff evolution;
- assets under management; and
- major projects underway.

Appendix 1

Excerpts from Real Estate Asset Manager Scorecard

Category	Score				
	1	2	3	4	5
Company & staffing					
Shareholding and financial standing					
Experience as FoHF manager and asset structure					
Corporate independence/governance					
Team structure and segregation of duties					
Executive management					
Investment professionals					
Risk and other supporting staff					
Weighted rating					
Risk management & controls					
Risk management and control structure					
Investment risk management					
Counterparty oversight					
Compliance procedures and controls					
Weighted rating					
Investment selection					
Investment strategy/clarity					
Research capabilities					
Market access					
Investment due diligence/analysis					
Weighted rating					
Portfolio management					
Market monitoring					
Asset monitoring					
Property management					
Financial portfolio and liquidity management					
Asset disposition discipline					
Weighted rating					
Investment administration					
Transaction processing and asset/portfolio accounting					
Investor reporting					
Valuation					
Technology resources					
Weighted rating					

Source: Fitch

Appendix 2

Asset Manager Ratings - Definitions

Fitch Ratings' Fund and Asset Manager Rating Group publishes ratings of asset management activities for the use of institutional investors, all of which are internationally comparable. The agency issues Asset Manager Ratings to provide investors with an independent assessment of an asset management organisation's vulnerability to operational and investment management failures.

Among others, these failures can take the form of:

- mismanaged risk budget;
- excessive counterparty risk taking;
- fund closure and/or fire sale due to miscalibrated liquidity or asset liability risks;
- illegal or unethical market practices (price manipulation, unfair dealing, insider trading);
- poor investment oversight leading to major style drift or run-off portfolios;
- inconsistency in investment decision-making leading to material financial losses;
- valuation, settlement/payment or subscription/redemption errors;
- miscommunication; and
- business disruption (for operational or financial reasons).

The ratings are issued on a five-tier scale of ('M1' - 'M5'), with 'M1' being the highest rating. The agency may further differentiate ratings by plus (+) and minus (-), as warranted by the scores achieved. The agency may change or withdraw a company's Asset Manager Ratings at any time based on information garnered from reliable sources, the agency's surveillance data and regular updates provided by the asset manager, or because of lack of information provided by the manager.

The agency assigns National Asset Manager Ratings to asset management companies operating in countries where, for some rating factors, a comparison with international standards is irrelevant. Those factors are evaluated taking into consideration local specificities. National Asset Manager Ratings, which display a special identifier for the country concerned, eg 'M3(mor)' for Morocco, are comparable only to National Asset Manager Ratings assigned in the same country.

Limitations of the Asset Manager Rating Scales

Specific limitations relevant to the rating scales applied to asset managers include the following:

- The Asset Manager Ratings relate to specific operational units and specific geographies within an asset manager – they do not necessarily relate to legal entities.
- The ratings do not predict a specific likelihood of asset manager failure over any given period.
- The ratings do not opine on the market value of any asset manager's investments, or that asset manager's own securities, or the likelihood that these values may change.
- The ratings do not opine on the liquidity of the asset manager's investments, or that asset manager's own securities.
- The ratings do not opine on the suitability or otherwise of an asset manager for investment or any other purposes.

- The ratings do not opine on any quality related to an asset manager's business, operational or financial profile other than an observational opinion on its operational strength in a limited number of areas.
- The ratings do not opine on the investment strategies implemented by the asset manager.

Ratings assigned by Fitch articulate an opinion on discrete and specific areas of risk. The above list is not exhaustive, and is provided for the reader's convenience.

Level 1 Rating - 'M1' - Superior

Asset manager operations demonstrating the lowest vulnerability to operational and investment management failure.

Level 2 Rating - 'M2' - Strong

Asset manager operations demonstrating low vulnerability to operational and investment management failure.

Level 3 Rating - 'M3' - Adequate

Asset manager operations demonstrating limited vulnerability to operational and investment management failure.

Level 4 Rating - 'M4' - Weak

Asset manager operations demonstrating elements of vulnerability to operational and investment management failure, including heightened risks regarding the match between the organisation's current and near-term competencies and its ability to adequately meet its business and investment management objectives.

Level 5 Rating - 'M5' - Deficient

Asset manager operations demonstrating material vulnerability to operational and investment management failure.

The organisation may, for example, have deficiencies in the infrastructure required to meet its business and investment management objectives; available financial information disclosed to Fitch may indicate uncertainty as to the organisation's ability to remain commercially viable over the following 12 months, or be insufficient to form a judgment on financial condition; or other management, risk control or operational practice deficiencies may be indicated.

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