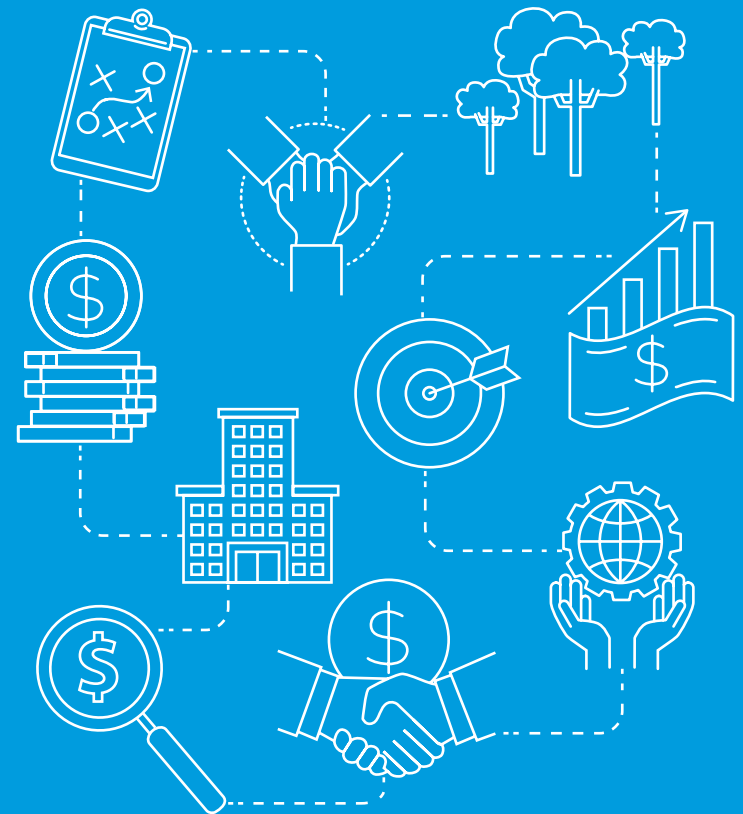


Targeting investors, diving into fundraising and more: **A guide for emerging funds**



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Targeting investors, diving into fundraising and more: A guide for emerging funds

At the start of the pandemic, commercial real estate investors were waiting on the sidelines, eager for the opportunity to dive back into the market.

Today, as interest rate hikes and inflationary pressures signal a potential looming recession, real estate investors are reevaluating valuations and strategies. Risk profiles are changing, as available capital targets less risky, value-add, core and core-plus assets, while backing off from opportunistic and debt funds, which can have more unknowns.

Against this backdrop, real estate investors are being more selective when searching for the best funds to trust with their capital.

Starting a new fund is not as simple as putting together a team and courting interested parties. It is a complex, multistep process that requires consideration of many important factors before the first round of fundraising kicks off. Whether you're an emerging fund or a seasoned professional, you need a solid framework in order to be successful in today's environment.

"Fundraising in a challenging economy requires significant due diligence and careful planning to mitigate risk," Tom Green, national real estate assurance leader for RSM.

Green and his colleagues at RSM often get questions from clients—those just starting out in emerging funds as well as seasoned professionals—about best practices for putting together a successful fund. The RSM team has put together this guide for emerging real estate funds.

Determine your strategy—and be prepared to pivot



KEY TAKEAWAYS:

- It's important to have a clear strategy, but funds also need to be flexible.
- Keep an eye on the environment and adjust accordingly.
- Keep investors up to date on any major strategy changes.

Scott Helberg, a real estate senior analyst for RSM, says that when a fund starts, it will put together a private placement memorandum (PPM) to outline its strategy. While that is an important first step, funds must remain flexible; fund managers need to constantly review their skill sets and strengths, as well as what's happening in the market.

"It's important to always reevaluate your strategy to make sure it's still aligned with your long-term company mission," Helberg says.

While the PPM has historically been important for disclosing information to investors and the general public, there is a stronger emphasis on it today due to heightened due diligence by investors. Helberg notes that if a fund's strategy does end up significantly deviating from it, fund managers need to connect with investors to ensure continued transparency.

Funds generally define their strategy based on the skill sets of their sponsors, says RSM's Green, adding that once that strategy is defined, managers will then consider other areas of focus, such as level of risk, investor mix and geography.

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It's important to always reevaluate your strategy to make sure it's still aligned with your long-term company mission.

Scott Helberg,
Real Estate Senior Analyst,
RSM US LLP



Target your investors



KEY TAKEAWAYS:

- Targeted investors should be selected using a variety of factors.
- A fund's size, sector and geographic markets all have an impact on targeted investors.
- Tax perspectives should be considered when targeting investor groups.

The types of investors a fund will target hinge on a variety of factors: asset classes, target markets, sectors represented, holding period, risk level and investment size, Green says.

"Depending on the size of the commitments that you're looking for, you may need to go to larger institutional, sophisticated investors," he says. "Those investors often require a lot of complexity in terms of structuring, which is something to keep in mind."

In today's uncertain market, fundraising from traditional sources has been much more challenging, with available capital going to larger funds with strong track records. This puts intense pressure on emerging funds to build their credibility if they hope to get a piece of the pie.

From a tax perspective, consider three groups: taxable investors, including retail investors, high net worth individuals and family offices; tax-exempt investors, such as pension funds, universities and foundations; and foreign investors, such as sovereign wealth funds whose capital flows from outside of the United States.

"There are (distinct) tax considerations that each group cares about when it comes to their real estate investment," Helberg says, noting that "those considerations need to be factored in when making a choice of which group to target."

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TO REIT OR NOT TO REIT?

Real estate funds considering setting up a real estate investment trust should also consider the impact on taxable investors.

[Learn more >](#)



Assemble a top team



KEY TAKEAWAYS:

- Find trusted business associates.
- Hire at least one person well known within the industry.
- Focus on credibility.

The way to source a strong management team is through thorough interviews and recommendations from trusted business advisors, says Veronica Bulman, RSM real estate audit policy leader, noting that group chemistry and alignment around strategy are important considerations.

An internal management team structure needs to be developed, says Green, and that structure is often built around one person who is already respected in the industry. A high-caliber representative helps the fund establish credibility, he says.

"Investors are more comfortable either working with the largest fund managers or redeploying with someone they've already invested with before," adds Green, who in recent years has seen reticence on the part of investors to work with new fund managers.

Once the right team is in place, it will be their job to identify the best service providers for the legal, accounting and fund administration functions.

Giving investors peace of mind that critical back-office functions will be executed by a reputable third party will also help the fund build credibility.

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With the right people, processes and technology, fund managers can build a virtual advisory dream team.

Discover how to vet a potential fund administration and advisory services provider.

[Discover how >](#)



Dive into fundraising



KEY TAKEAWAYS:

- Find a way to stand out.
- Focus on current trends and new technologies that increase transparency.
- Emerging funds have a leg up today, as large investors seek diversification.

Finding the fund's market differentiation is essential for successful fundraising, particularly in a crowded field. Some considerations: Does anyone involved with the fund have an outstanding track record? Are the fund's policies and procedures in line with what the targeted investors would require? Does it have the technology in place to deliver on its strategy?

With the coming transfer of wealth to the next generation, more investors are demanding transparency—they want dashboard access to their investments in the palm of their hand, says RSM Real Estate Senior Analyst Lauren Gerdes. This is why technology has become such an important tool for attracting investors, she says.

"Raising capital is, of course, challenging, especially for emerging managers," says Gerdes. "But right now, in the current environment, deploying capital can be even harder—having the right technology to source deals, underwrite and get to the table faster can be appealing to potential investors."

An advisor on the team who can guide fund managers through important issues such as the fund's stand on social impact and cybersecurity, among others, can be a game changer when helping a fund stand out from the competition, she adds.

Managers may be able to leverage a corporate social responsibility angle to their advantage when fundraising, Green says. There is a mandate among larger institutional investors to be stewards within the real estate sector, so they are often looking for opportunities to work with emerging and diverse fund managers as part of their own CSR initiatives. Many larger state pension funds, for instance, have so-called emerging manager programs so they can partner with funds that fulfill their CSR strategies.

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REAL ESTATE EMERGING FUNDS OUTLOOK

Real estate emerging fund managers may look to niche strategies and better data to overcome the denominator effect challenge.

[Discover how >](#)



Build a structure



KEY TAKEAWAYS:

- There are two components to building a fund structure—legal entities and fee arrangements.
- Funds can have a flexible structure, but it could cost them.

Emerging funds have two main considerations regarding structure—determining their legal entities and establishing their fee arrangements, including fund manager compensation.

When deciding on entities, consider: What type of investors is the fund targeting? Is it an open-end or closed-end fund? What is the planned hold period for certain assets? In what sectors is the fund looking to invest?

“There are structures in place that can provide more flexibility if a fund hasn’t necessarily decided what path it’s going down,” Helberg says. “But it’s also important to recognize there’s a potential increased cost in getting that flexibility, whether through compliance fees or tax leakage, which means less cash flow to your investors.”

Two means for fund manager compensation exist: One is the management fee, typically a percentage of capital committed or invested that tends to run about 1.5%, depending on negotiations with investors. The second is carried interest received on the back end of the fund’s life, as assets are sold.

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CARRIED INTEREST

Stay up-to-date on the latest rules and regulations for real estate fund managers.

[Visit the RSM Tax Policy Resource Center >](#)



Outsource to elevate operations



KEY TAKEAWAYS:

- More than half of U.S. middle market private equity firms are choosing to outsource fund accounting and administration.
- With the right people, processes and technology, fund managers can build a virtual advisory dream team.

Identifying which processes to keep in-house and which to outsource is another consideration for real estate fund managers, one particularly challenging for those new to the role. Consider a developer that historically had a sole source of equity and decides to move into the fund space. Suddenly, the organization needs to meet investor reporting requirements—including K-1 distributions and quarterly reports—and faces tighter restrictions on accounting.

Outsourcing of fund administration in the private equity industry has experienced a dramatic upward trend in recent years. In less than a decade, the percentage of U.S. middle market private equity firms using a third-party fund administration solution has increased from around 25% to nearly 60%.

The factors driving this trend are well documented and numerous. With the limited partner community fully embracing the outsourcing of fund administration, and with so many fund managers and chief financial officers having now adopted outsourcing in some capacity, there is a growing realization that handling everything in-house can be a waste of precious resources. This belief has gained further traction in light of the growing talent shortage, rising costs of technology, and overall economic and human capital commitment required to maintain an in-house accounting and administration team.

Fund administrators invest considerable time and money into implementing sophisticated technology, refining their reporting and business processes, building dynamic investor dashboards, incorporating tax-related functionality, and developing career paths for everyone on the fund accounting team. When taking these costs into consideration, outsourcing can make good business sense, particularly for emerging managers.

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6 CAPABILITIES OF BEST-IN-CLASS FUND SERVICES

Fund administration is a complex, time-consuming job. Funds that go it alone have more operational challenges.

Discover how next-gen fund administration services elevate operations

[Download the guide >](#)





Demonstrate corporate governance

KEY TAKEAWAYS:

- Investors expect clear corporate governance policies for the fund.
- A written mission statement is essential.
- Corporate governance policies should be reexamined regularly.

Emerging funds should establish and demonstrate their corporate governance—rules, practices and processes by which their fund is directed and controlled—to convey to investors their commitment to running a professional, responsible organization.

“Today’s investors really care about whether a fund is governed correctly, and whether it has the appropriate mechanisms in place to oversee the funds in a responsible manner,” RSM Real Estate Senior Analyst Sarah McKevitt says.

Among the best practices she recommends are including the mission or values statement on the fund’s website and in marketing materials to convey a commitment to transparency, and establishing written policies for valuation compliance and cybersecurity. Reassessing those policies on a regular basis is also important, McKevitt says.

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FLEXIBILITY AND RESILIENCY

The investor relations burden has become heavier for managers as investors have demanded more information during the COVID-19 pandemic.

What is shaping managers' decisions?





Consider the growing influence of ESG

KEY TAKEAWAYS:

- Environment, social and governance initiatives are increasingly important to investors.
- Funds need a way to communicate their ESG commitment.
- Younger investors are putting a greater emphasis on ESG.

Against the backdrop of heightened public concerns around the environment, fair trade and social equity, ESG considerations are now at the forefront for many businesses, and real estate is no exception.

“Whether you're trying to attract retail investors or institutional capital, these investors are viewing ESG to be a core part of their due diligence process,” Helberg says. “They’re not only looking at the financial returns of their investment but also the societal impact.”

Troy Merkel, RSM national real estate consulting leader says having an ESG story embedded in a company's go-to-market pitch can greatly help with raising capital. “A lot of the major shops have a significant ESG component when they're going to market to fundraise,” he says.

Meanwhile, the importance of ESG to the middle market is rising, RSM's data show. Some two-thirds of middle market organizations already had formal plans to showcase their ESG initiatives, according to the third-quarter RSM US Middle Market Business Index survey, which polled executives at midsize companies on ESG and climate-related issues. Helberg says it's imperative that funds demonstrate their commitment to ESG.

“The largest real estate managers and investors have already publicly committed to having an ESG focus,” Helberg says. “For example, many are targeting their investment portfolios to have net-zero gas emissions by 2050. With the mission starting from the top, it's going to continue to trickle down, particularly to our middle market clients.”

For middle market clients—most of whom do not have internal staff dedicated to the ESG function—the hardest part about ESG initiatives is knowing where to start. RSM works with both emerging and established real estate funds to help develop ESG tracking methods, reporting frameworks and long-term goals.

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ESG BEST PRACTICES FOR PRIVATE EQUITY FUND MANAGERS

Investment managers are realizing the business value of tracking ESG for raising capital and attracting diverse top talent.

[Discover how >](#)





Ensure transparency for investors

KEY TAKEAWAYS:

- Today's investors expect greater transparency.
- Technology can go a long way toward providing openness.
- RSM has a new tool that can help.

In addition to seeing strong returns, investors want to feel confident they know how a fund is deploying their capital, and it is important to be as transparent as possible.

One way to establish transparency with investors is through well-written fund documents, including the PPM and operating agreement. Next is a standard cadence of external reporting—an annual report that includes an audit, as well as quarterly reports that cover all investments. Funds should also identify conflict-of-interest policies and be vigilant regarding disclosures.

“We've seen that it's very beneficial to have an advisory or a limited partner advisory committee as part of the overall investor team that interacts with the management of a fund,” says Green.

Emerging fund investors expect strong internal controls to reduce reputational, compliance and financial risks related to their investments, says Nate Ruey, an RSM risk advisory services partner. Manuals that spell out internal control policies and procedures on everything from cash management to cybersecurity help provide a holistic approach, he says.

RSM PARTNERSIGHT TECHNOLOGY BOOSTS TAX TRANSPARENCY

Investors hungry for information don't just want to see their K-1s; they want detailed information customized for their specific needs, provided quickly in an easy-to-control format. To that end, RSM has developed **PartnerSight**, a new technology focused on providing tax transparency from the property level on up. PartnerSight allows emerging funds to leverage their data, build better projections and make informed decisions on tax compliance issues.

“PartnerSight gives our clients full access to their tax data, right at their fingertips—allowing for smoother investor relations,” says RSM Real Estate Senior Analyst Helberg. “We're seeing consistent questions on a quarterly, and sometimes monthly, basis as investors want to know what's happening in their funds, and how it could impact their eventual tax dollars.”

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