



MARCH 2020
SUMMARY OF SPOT
INSPECTIONS 2019

CONDITIONS OF PROVISION OF
REAL ESTATE MANAGEMENT
SERVICES

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INTRODUCTION

As announced in the AMF's supervision priorities for 2019, the third series of SPOT inspections for 2019 targeting portfolio asset management companies ("AMCs") concerned the conditions of provision of real estate management services for six market participants, in particular regarding the monitoring and selection of outside service providers.

The verifications mainly covered the period 2016-2019 and examined:

- The organisation of the AMCs with regard to asset management and property management (internal resources, outsourcing to third-party companies, etc.) ;
- The procedural corpus relating to these activities;
- The procedures for selection of outside real estate service providers;
- The pricing conditions for these real estate services;
- Information for investors¹ concerning these services (organisation adopted, procedures for calculating fees, amount of fees effectively payable by the fund, etc.);
- Conflict of interest management relating to these activities;
- The control system (permanent and periodic) relating to these services.

This review aims to shed light on the practices of the AMCs under review with regard to their arrangements for the provision of real estate services.

Based on the outcome of this series of SPOT inspections, the AMF has identified a number of areas where improvements would need to be implemented by the inspected AMCs.

This document is neither a position nor a recommendation. The practices identified as 'good' or 'bad' stress approaches observed during the inspections which for the first ones could facilitate, and for the latter could hamper effective and sustainable risk management of the provision of real estate services and their potential consequences at operational level and regarding compliance with applicable regulations.

¹ Unitholders, shareholders or partners, depending on the type of vehicle.

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1- SUMMARY OF THE MAIN FINDINGS OF THE INSPECTIONS

The inspection task force noted that in practice real estate fund management breaks down into three parts:

- *fund management;*
- *asset management; and*
- *property management.*

Fund management covers tasks relating to both the assets and liabilities of the funds, which do not necessarily entail tasks pertaining to the management of underlying real estate assets² and, depending on the case, tasks related to the investment function, in particular the identification and/or evaluation of investment opportunities.

Asset management (as understood in the context of real estate fund management) and property management cover tasks specifically concerning the real estate assets held by the funds. The inspections therefore focused more specifically asset management (hereafter "AM") and property management (hereafter "PM"). Since these functions are not defined by the regulations, they may cover different scopes from one asset management company to another, or even from one fund to another. The inspection task force therefore conducted its investigations based on the definitions adopted by each of the market participants in the sample group. Although this does not constitute a definition of what they cover in the area of real estate fund management, it was considered, schematically, that the AM function aims to define and apply a strategy to optimise the valuation of the assets, and that the PM function consists of operational management of the asset while it is held, via rental management and technical management.

For the AMCs in the sample group, the inspections showed that the AM function was usually performed in-house by the AMC, in some cases with the support of third-party companies, whether it be for example in an advisory role with the AMC or in a role of execution of the AMC's decisions. As regards PM, technical management is usually performed by outside service providers, while rental management is frequently carried out by in-house personnel. In several cases, the selected service provider forms part of the AMC's parent Group.

The inspections show that most of the AMCs in the sample group do not have sufficiently precise and operational procedures covering the processes relating to AM and PM. For example, in a significant number of cases, the procedures did not cover the conditions of asset sale, the processes followed for rent invoicing and lease management, the procedures for monitoring overdue rents and expediting tenants, the procedures for managing expenses paid by the tenant, the nature and frequency of reports to be produced, etc. However, the inspections identified several good practices which are outlined in this document.

When the service is performed by a third-party company, the inspections found, in most cases, that the traceability of the selection process was insufficient (e.g. because the tender documents were not complete). Accordingly, it was not always possible to make sure that the service provider was chosen in accordance with the principles of the selection procedure, and based on factual and objective criteria.

Similarly, regarding quality control of the service performed, the controls were insufficiently formalised and traced. Regarding selection, the inspections nevertheless found good practices, concerning not only the formalisation of analysis of the replies received to invitations to tender, but also formalisation of the choice of service provider.

The pricing conditions for AM and PM services vary depending on the AMC and the fund. For example, in some cases AM expenses and PM expenses are calculated separately. In other cases, these expenses are not isolated (for

² Appendix X of AMF Instruction No. 2011-23 identifies real estate fund management, within the framework of real estate collective investment undertaking (OPCI) management, as follows: "*namely the establishment of the investment strategy and the general business plan of the OPCI and the allocation among the real estate pocket, the financial pocket and liquid assets, the identification and evaluation of investment opportunities, the determination of financing methods for real estate assets and, where applicable, financial assets, determination of the procedures for realising the real estate and financial assets and liquid assets of the OPCI, services related to information obligations with regard to the Autorité des Marchés Financiers (AMF) and shareholders/unitholders, and in particular preparation of the annual management report and the periodic information documents.*"

example, the AMC charges a percentage of the value of the buildings which covers both AM and fund management). The invoicing assessment bases are also variable: lump sum, percentage of rents (the type of rent to be taken into account may also vary: rent collected, etc.), percentage of asset value, etc. Notably because of the variety of types of assets, the organisations adopted by the AMCs and the invoicing procedures, the inspections did not make a comparative analysis of pricing levels.

Generally, the information for unitholders concerning AM and PM services is not very detailed or is non-existent. This is because, ex ante, the regulatory information documents do not, in their standard templates, require that information be provided concerning the organisation adopted regarding AM and PM (insourcing or outsourcing, scope of operation of the service providers, etc.). As regards the expenses relating to AM and PM:

- in the case of real estate collective investment undertakings (OPCI), in accordance with the model plan of the prospectus (Appendix X to AMF Instruction No. 2011-23), the only data entered are the maximum rates that can be charged for "*operating and management fees*" (which admittedly cover AM, but also other AMC fees and other types of expenses) on the one hand, and the average rates for "*real estate operating expenses*" (which indeed cover the remuneration of PM service providers, but also all sorts of other expenses: taxes, insurance premiums, marketing costs, etc.);
- in the case of real estate investment companies (SCPI), the regulatory documents (PRIIPS KID and information prospectuses) respectively present aggregated cost information and certain information relating to costs that could come under AM or PM services.

Taking into account, in particular, the methods for calculating these costs, the ex-post documentation (annual reports, periodic information documents, etc.) does not, in most cases, contain detailed information relating to the actual cost of AM and PM as a whole.

The selection of real estate service providers can be a source of potential conflicts of interest, especially when the AMC selects a service provider forming part of its parent Group. Such conflicts of interest have to be identified and managed by AMCs. The inspections checked that the AMCs in the sample group had indeed set up a conflict of interest management system governing the selection of service providers. In half of the cases, however, this system was not fully operational in practice, insofar as the invitations to tender and/or consultations (which are the measure for supervising conflicts of interest) were not sufficiently traced. The inspections also detected two situations of conflicts of interest (related to the selection or pre-selection of "group" service providers not covered by a formalised justification).

All the AMCs in the sample group (except one AMC) have indeed set up second-level controls relating to the selection of service providers, fees and conflict of interest management. One of the AMCs has also established periodic controls concerning fees and the selection of service providers. However, the traceability of these various controls (both permanent and periodic) was not always sufficient.

2- CONTEXT AND SCOPE

2.1- PRESENTATION OF THE SAMPLE OF AMCS INSPECTED

The AMCs were selected so as to form a varied sample group in terms both of types of fund (real estate collective investment undertakings and real estate investment companies in particular), clients, size of funds (assets under management of between €500m and €2bn) and types of assets held. The sample group accordingly comprises:

- **Four AMCs managing funds (mainly real estate collective investment undertakings (OPCI) and professional real estate collective investment undertakings (OPPCI)) held exclusively by professional or equivalent clients. These AMCs operate on a broad variety of real estate asset classes:**
 - AMC 1: mainly residential assets;
 - AMC 2: offices, shops and hotels;
 - AMC 3: offices and shops;
 - AMC 4: all types of assets (residential, offices, logistics, shopping centres, etc.);

- Two AMCs managing real estate investment companies (SCPIs) held mainly by retail clients:**
 - o AMC 5: all types of assets (premises for commercial and professional use, offices, and very marginally residential assets);
 - o AMC 6: mostly commercial - and more marginally residential - real estate.

The investigations covered the period from 1 January 2016 to 20 October 2019.

2.2- APPLICABLE REGULATIONS

The work of the inspection task force was based on:

- Commission Delegated Regulation (EU) No. 231/2013 of the AIFM Directive of 19 December 2012;
- the Monetary and Financial Code;
- the AMF General Regulation;
- AMF Instruction No. 2011-23 (Authorisation and establishment processes for a KIID and/or a prospectus and periodic information for real estate collective investment undertakings and professional real estate collective investment undertakings);
- AMF Instruction No. 2019-04 (Real estate investment companies, forestry investment companies and forestry investment groups);
- AMF Position-Recommendation 2014-06 (Guide to the organisation of the risk management system of asset management companies);
- AMF Position-Recommendation 2012-19 (Guide to preparing the programme of operations for asset management companies and self-managed collective investments);
- the code-of-ethics rules of real estate collective investment undertakings (OPCI), approved by the AMF;
- the code of ethics of real estate investment companies (SPCI), approved by the AMF.

Main legal sources

Compliance with authorisation requirements

- a) Article L. 532-9 of the Monetary and Financial Code and 317-1 to 317-7 of the AMF General Regulation concerning **compliance with the authorisation requirements at all times;**

Procedures

- b) Article 61.1 of Delegated Regulation 231/2013 concerning **the procedures to be established and complied with by the AMC;**

Selection and monitoring of service providers, and price scale

- c) Paragraph 3.2.9.2 of AMF Position-Recommendation 2012-19 on the **selection of service providers, periodic re-assessment of the services provided and information for unitholders;**
- d) Article 318-61 of the AMF General Regulation on the **outsourcing of operational tasks or functions by AMCs, and the evaluation and monitoring of those service providers by the AMC;**
- e) Articles 10 and 11 of the code of ethics of OPCIs on the **use of entities related to the asset management company;**
- f) Articles 14 and 15 of the code of ethics of OPCIs, on the **system for selection of service providers and the traceability of that system;**
- g) Article 16 of the code of ethics of OPCIs on the **conditions of signature or renewal of lease agreements and all the other conditions negotiated with the tenants or accepted by them;**

- h) Article 422-224 of the AMF General Regulation on the remuneration of SCPI management companies;
- i) Articles 20, 21 and 36 to 38 of the code of ethics of SCPIs, on the use of affiliated companies and relations with service providers;

Information for unitholders

- j) Article 422-179 of the AMF General Regulation on the **description in the prospectus of the fees incurred by the unitholders** of OPCIs;
- k) Articles L. 533-22-2-1 of the Monetary and Financial Code, 103 of Delegated Regulation (EU) No. 231/2013 and 23 of AMF Instruction 2011-23 concerning, in particular, **the clear, accurate and non-misleading nature of the information provided for unitholders**;
- l) Article 3.1.3 of AMF Instruction 2019-04 and Articles 422-198 and 422-227 of the AMF General Regulation, on **information for SCPI shareholders regarding fees in particular**;

Conflict of interest management

- m) Articles L.533-10 I (3) of the Monetary and Financial Code, 318-13 and 319-3 (4) of the AMF General Regulation, and Articles 30, 31, 33 to 36 of Delegated Regulation 231/2013 on **conflict of interest management**;

Control system

- n) Articles 57.1. c and 61.2. a of Delegated Regulation (EU) No. 231/2013 **on internal control mechanisms and the permanent compliance verification function**.
- o) Article 318-49 of the AMF General Regulation on the compliance and internal control system and Article 62 of Delegated Regulation (EU) No. 231/2013 **on the periodic control system**.

3. OBSERVATIONS AND ANALYSES

3.1- ORGANISATION OF THE AMCS AND EXISTENCE OF PROCEDURES

➤ **Definition of the scope of Asset Management and Property Management according to the companies in the sample group**

"AM" and "PM" may cover different scopes depending on the AMC, or even depending on the fund. For example, the following differences were identified by the inspections:

- Half of the AMCs in the sample group consider that the AM function starts when the asset comes into the portfolio. Conversely, the other half consider that the work prior to acquisition (market research, analysis of the asset, acquisition process, etc.) comes under AM;
- In the case of residential assets, the AMCs in the sample group consider that rental property marketing comes under PM, while in the case of other assets, they generally consider that this comes under AM.³

Schematically, however, except in some cases, research shows that:

³ This can be explained insofar as the letting of housing is very different from renting out another type of asset, such as premises in a shopping centre, for example. In the case of a housing unit, it will be an "industrial" process (a sometimes large number of units to be marketed at the same time, pricing based on a predefined grid, large number of dossiers from rental applicants to be analysed, etc.). In the case of premises in a shopping centre, other strategic and financial aspects will be involved: suitability of the type of shop (ready-made clothing, jewellery, etc.) in relation to the requirements and needs of the shopping centre, brand recognition and financial strength of the chain, possible bargaining over the amount of rent, etc.

- **The purpose of the AM function is to define and implement the strategy aimed at optimising the valuation of the asset**, and generally covers at least the following aspects:
 - definition of the rental strategy;
 - supervision of marketing and relations with brokers (excluding residential assets);
 - definition of the strategy concerning major works (i.e. excluding routine maintenance and repair work) and definition of the multi-year work plan;
 - modelling of business plans (cash-flow projections, etc.) and asset performance monitoring/reporting;
 - role of interface with PM;
 - proposals for the disposal of assets in the portfolio.

- **The PM function involves operational management of the asset currently held by the fund**, via two aspects:
 - rental management: rent invoicing and collection, monitoring of vacancy rates (physical vacancy and financial vacancy), monitoring of expenses paid by the tenant and taxes (receipt, validation and payment of invoices, and re-invoicing to the tenants where applicable), follow-up of insurance, etc.;
 - technical management: management and follow-up of repair, reconditioning and routine maintenance work (and within this framework, selection and supervision of technical contractors if necessary), claims management, etc.

➤ **Organisation regarding AM and PM**

The organisation regarding AM and PM differs from one AMC to another, and may also vary for a given AMC, depending on the fund or the asset (depending, for example, on whether it is a single-tenant asset or not, whether it is located in France or abroad, etc.).

The AM function is usually performed in-house by the AMC. However:

- AMC 1 is in some cases supported by outside service providers (e.g. in an advisory role on asset classes different from the AMC's core business);
- AMC 2 performs AM in-house for all its assets held in France, but AM for the assets held abroad is performed by another company (which is a member of the same group as the AMC);
- AMC 3 relies entirely on its in-house personnel for certain assets. For the other assets, however, it keeps the strategic and decision-making aspects (for example, the AMC alone has the power to approve a business plan or to establish a sales contract), but is also supported by outside service providers, which perform the following duties:
 - advice to the AMC;
 - execution of the AMC's decisions;
 - interfacing with PM.

As regards PM, technical management is usually performed by outside service providers, while rental management is, in several cases, carried out by in-house personnel:

- AMCs 1, 3 and 4 have outsourced all PM;⁴
- AMCs 2 and 5 have kept rental management in-house, but have outsourced technical management;
- in the case of AMC 6:
 - for residential assets, PM is entirely outsourced;

⁴ Except for one fund in the case of AMC 1.

- for office assets:
 - if the asset is single-tenant, PM is generally performed in-house;
 - if the asset is multi-tenant, technical management is delegated to an outside service provider, while rental management is performed in-house.

In several cases, outsourcing is performed to companies forming part of the same group as the AMC:

- AMC 1 in some cases outsources PM to a company forming part of the same group;
- in the case of assets located abroad, AMC 2 outsources AM to a company forming part of the same group;
- AMC 5 outsources part of the technical management of certain assets to a company in the same group.

➤ **Procedural corpus relating to AM and PM**

Only two out of six AMCs (Nos 5 and 6) have relatively precise and operational procedures covering the processes relating to AM and PM. Note that:

- the procedures of AMC 1 are admittedly insufficiently precise regarding PM in particular, but the AMC has a procedure for preparation and monitoring of the annual budget and the multi-year work plan;
- AMC 5 has a procedure for acceptance and management of tenants;
- AMC 6 has a procedure relating to preparation of the works budget.

In the case of the other four AMCs:

- They have procedures which cover only part of the AM scope, and/or which simply list the tasks relating to AM. For example, one or more of the following aspects are missing:
 - asset marketing procedures (establishment of the relationship with brokers, process of acceptance of tenants, etc.);
 - nature and frequency of business monitoring reports and documents produced by the asset managers;
 - process to be followed when the asset managers propose asset disposals;
 - etc.
- They sometimes have an insufficiently precise PM procedure, or even have no procedure. For example, one or more of the following aspects are missing:
 - processes complied with for rent invoicing and lease management (follow-up of payment schedules, rent indexing, etc.);
 - procedures for monitoring overdue rents and procedures and deadlines for expediting tenants;
 - procedures for managing expenses paid by the tenant (including process to be complied with for validation and payment of invoices) and taxes;
 - process to be complied with in accounting for expenses paid by the tenant;
 - methods for selection and supervision of technical contractors;
 - instructions on the procedure to follow for claims;
 - process to be complied with for the selection and follow-up of insurance;
 - asset marketing procedures;
 - nature and frequency of reports and monitoring documents to be produced;
 - procedures for decision making and supervision regarding routine maintenance work;
 - conditions and frequency of exchanges between PM and the AMC or AM, and information on the possible formalisation of exchanges (minutes of meetings, etc.);
 - etc.

➤ **Procedural corpus relating to the selection and supervision of real estate service providers**

Three out of six AMCs (Nos 1, 5 and 6) have relatively precise and operational procedures covering the selection and supervision of AM and PM service providers. For example:

- The procedure of AMC 1 describes in detail the various types of information which must appear in specifications, the list of documents to be provided by service providers before signature (proof of occupational risk insurance, etc.) and the main selection criteria to be taken into consideration. Moreover, the procedure stipulates that the selection of the service provider must be formalised by means of an assignment report describing in detail the various selection criteria;
- The procedure of AMC 5 defines the selection criteria applicable to each category of service provider;
- AMC 6 has a work performance procedure which indicates the number of companies to be consulted and the form of consultation, depending on the estimated financial amount to be committed.

In the case of the other three AMCs:

- They have selection procedures, but they do not cover one or more of the following aspects:
 - minimum number of service providers to be questioned;
 - precise nature of the documents (specifications, documents relating to assets held by the funds, etc.) to be sent to the service providers questioned;
 - expected reply times;
 - list of documents expected from the service providers questioned;
 - procedures for analysis of the replies received and criteria taken into consideration;
 - decision making method and decision traceability (minutes of committee meeting, etc.).
 - etc.
- Except for AMC 4, they have a procedure which mentions supervision of service providers. However, here again the procedures are not sufficiently precise, since the following information is not indicated:
 - nature of the information and documents to be collected with a view to evaluation;
 - criteria and indicators to be taken into consideration to make the evaluation.

Regulatory reminders:

- AMCs shall establish, implement and maintain policies and procedures designed to detect any risk of failure to comply with their professional obligations and related risks, and shall put in place adequate measures or procedures particularly to attenuate those risks (Article 61.1 of Delegated Regulation 231/2013).
- As specified in AMF Instruction 2012-19 (paragraph 3.2.9.2), "*the company must implement a service provider selection process based on objective selection criteria and enabling competitive bidding. This procedure must also provide for periodic reassessment of the services provided (at least annually)*".

Good practice:

- Have procedures that are as comprehensive as possible, detailing in particular (1) the processes related to AM (validation of business plans, multi-year work plans and tenants, etc.); (2) the processes related to PM (rent invoicing and collection, management of expenses paid by the tenant, etc.); (3) the procedures for selection of AM and PM service providers (types of consultation and criteria to be taken into consideration, distinguishing between the various types of service providers; list of documents to be demanded of service providers, etc.); and (4) the procedures for supervision of AM and PM service providers (frequency of assessment, criteria and indicators to be taken into consideration in the supervision process, etc.).

3.2- SELECTION AND MONITORING OF REAL ESTATE SERVICE PROVIDERS

➤ Procedures for selection of service providers

The inspections found the following practices with regard to the selection of service providers:

- request for proposal sent to several service providers (with which the AMC and its funds do not necessarily have a prior business relationship);
- competitive tendering by the incumbent service provider with other market participants (usually service providers already involved on other assets held by the AMC's funds);
- continuation of the contract with the service provider which was already in place at the time of acquisition of the real estate asset;
- for funds held by a limited number of institutional investors, choice of the service provider by the AMC, by agreement with the unitholders, at the time of the fund's organisation.

➤ Traceability of the process of selection of service providers

For each of the AMCs, the inspections tested the traceability (and compliance with the procedure where applicable) of the process of selection of a sample of service providers.

These tests showed that the traceability of the process was satisfactory for only two out of six AMCs (AMCs 1 and 6):

- AMC 1 was able to provide the inspection task force with the name of the service providers questioned and the proposals submitted. The AMC also submitted to the inspection task force assignment reports, indicating the criteria based on which the final choice was made;
- Regarding AMC 6, the inspections found that a weighting was assigned to each of the selection criteria (technical criteria, economic and commercial criteria, etc.). The AMC submitted to the inspection task force a summary table presenting the main data used to determine the scores for the various criteria. Lastly, the AMC submitted to the inspection task force their exchanges with the tender candidates. The inspection task force thus noted that the AMC presents the reasons for non-selection to the service providers which have not been selected.

For the other four AMCs, it was noted that:

- The AMCs did not always submit to the inspection task force information enabling it to understand the criteria based on which the service provider was chosen;
- The AMCs did not always submit to the inspection task force the document (minutes of committee meeting or other) ratifying the final choice.

Moreover, concerning an invitation to tender on one of its funds, during the inspection AMC 3 was unable to find the documents relating to the request for proposal.

Lastly, a case of failure to comply with the procedure was detected in the case of AMC 4: for several assets, a single property manager was questioned (which was therefore ultimately selected), whereas under the selection procedure and the conflict of interest management system established by the AMC, a request for proposal ought to have been carried out.

➤ Monitoring of service providers

The AMCs in the sample group all perform first-level controls relating to real estate service providers. However, in four out of six cases (AMCs 1, 2, 3 and 4), these controls are insufficiently formalised and traced.

These evaluations are generally made on the basis of evaluation grids, with a score or an assessment ("satisfactory", "very satisfactory", etc.) assigned for various items ("price", "compliance with deadlines", "availability and reactivity of market participants", etc.). However, the sheets contain very few or even no comments making it possible to understand the criteria and tangible indicators based on which these scores/assessments are determined.

This is especially problematic in that, in some cases, these evaluations concern service providers for which no selection process has been performed beforehand (for example, because the AMC kept the service provider which was incumbent at the time of acquisition of the asset, without placing them in competition again, neither at the time of the acquisition nor later during its possession of the asset). Now, only this evaluation could make it possible to check the advisability of keeping the service provider in question.

Regulatory reminders:

- For the selection of service providers, the AMC must act in the best interests of the AIFs and AIF unitholders, take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, where applicable, disclose those conflicts of interest (Article 319-3 of the AMF General Regulation).
- AMCs shall exercise due skill, care and diligence when entering into, managing or terminating an outsourcing contract for critical or important tasks or functions. They must in particular take all measures to ensure that the following requirements are met: (1) The service provider must have the ability, capacity, and any authorisation required to perform the outsourced tasks or functions reliably and professionally; (2) the service provider provides the outsourced services effectively. For this purpose, AMCs shall define methods for evaluating the service provider's level of performance [...] (5) AMCs must retain the necessary expertise to supervise the outsourced tasks or functions effectively and manage the risks stemming from outsourcing and must supervise those tasks and manage those risks (Article 318-61 of the AMF General Regulation).

Good practices:

- In the case of a request for proposal or competitive tendering (or any type of selection process), formalise a grid or summary document making it possible to compare the suitability of the replies by the service providers questioned, on all the relevant selection criteria according to the context (price, suitability of the service provider's ideas, number of full-time personnel assigned by the service provider, etc.). Provide for hierarchic ranking and/or weighting of the selection criteria in this document.
- Formalise the final choice of service provider, on a medium appropriate for the decision-making process existing in the AMC (e.g. minutes if the decision is taken in a committee meeting, or mere email if the decision is taken by a manager) in order to ensure the traceability of this choice.
- Explain to the service providers not selected the reasons why they were not selected, to ensure the transparency of the process.

Bad practices:

- Not sufficiently tracing implementation of the selection process.
- Evaluating service providers in a primarily discretionary manner, without defining objective indicators capable of underpinning the assessments made concerning the quality of the services provided.

3.3- PRICING CONDITIONS OF REAL ESTATE SERVICES

The conditions and assessment bases for pricing of AM and PM services vary depending on the AMC and the fund (invoicing on a fixed-price basis, as a percentage of asset value, of the value of rents invoiced, rents collected, etc.). The table presented in appendix summarises these conditions schematically.

3.4- INVESTOR INFORMATION CONCERNING REAL ESTATE SERVICES

➤ **Ex-ante information concerning the organisation selected, the identity of outside service providers and the procedures for calculating fees**

In the ex-ante regulatory information documents, no detailed information is given to investors concerning the organisation selected regarding AM and PM (list of functions performed internally and functions outsourced, procedures for selection of service providers, etc.), since such information is not required in the standard models.

However, during an inspection, AMC 6 proposed adding to its prospectuses, mentioning in particular that:

- the AMC can outsource fund management and AM duties to third parties, including companies in its parent Group;
- the procedures for selection of subcontractors (consultation of several market participants or request for proposal) vary depending on the amounts involved.

In the same way, no detailed information is given to investors concerning the procedures for calculating fees related to AM and PM:

- In the case of OPCIs, information is provided concerning the maximum rates that can be charged for "*management and administration fees*" on the one hand and the average rates for "*real estate operating expenses*" on the other hand;

Anonymised example of an OPPCI managed by AMC 2:

It is stated in the prospectus that:

- **management and administration fees** will not exceed [X]% VAT inclusive of the net asset value and [X]% VAT inclusive of the gross asset value.

These fees include the AMC's remuneration for asset management, but also:

- ⇒ the AMC's remuneration for fund management: establishment of the fund's investment strategy and general business plan, allocation among the various pockets (real estate, financial and liquid assets), determination of the financing conditions for real estate assets, preparation of the annual management report and periodic information documents, etc.;
- ⇒ fees and expenses related to the fund's administration and its corporate life: fees of the custodian, statutory auditors, lawyers, operating expenses of governing bodies, etc.);
- ⇒ fees related to asset valuation, and notably the fees of third-party valuation appraisers.

- **Real estate operating expenses** will represent [X]% VAT inclusive of the net asset value and [X]% VAT inclusive of the average gross asset value over the next three years.

These fees include the remuneration of outside service providers for property management, but also the following expenses, if they are not re-invoiced to the tenants and cannot be capitalised in the fund's assets:

- ⇒ taxes (property tax in particular);
- ⇒ lighting, water, electricity and air conditioning costs, etc.;
- ⇒ insurance premiums;
- ⇒ payroll costs for caretaking and security;
- ⇒ costs related to rental marketing;
- ⇒ expenses for improvements, servicing, cleaning, maintenance and repair, etc.;
- ⇒ etc.

- In the case of SCPIs, the regulatory documents (PRIIPS KID and information prospectuses) present, in the sections dedicated to expenses, certain information relating to costs that could come under PM services. This information does not enable the investor to have a clear view of the cost of AM and PM services, such a level of precision being not required by the standard models of the regulatory documents.

Anonymised example of the prospectus of an SCPI

The AMC is remunerated by three types of fees including management fees equal to a fixed amount of [X]% excluding VAT based on rental revenues collected and the company's net financial revenues. Some categories of fees do not come within this fixed rate for investment management, including, for example, insurance, auditors' fees, letting fees, real estate valuation fees, litigation costs, etc. The list of these types of costs payable by the SCPI is presented in the prospectus.

➤ ***Ex-post information concerning the amount of fees relating to real estate services***

In four out of six cases (AMCs 3, 4, 5 and 6), the ex-post documentation (annual reports, periodic information documents, etc.) makes no distinction, apart from a view of overall costs, between detailed information relating to asset management and property management fees, since the information provided concerning overall costs does not go into this level of detail.

On the other hand, AMCs 1 and 2 present, at least for certain funds, a finer granularity (although without systematically giving information making it possible to separate AM from PM fees):

- AMC 1 presents finer aggregates, and/or presents the ratio between fees and the value of the assets:
 - for one of the funds, the annual report contains a table breaking down the operating profit, which specifies the amounts of rental management fees, marketing fees, etc. These amounts are also expressed as a percentage of the net assets and the value of the assets;
 - for another fund, the annual report presents the costs relating to real estate assets (acquisition costs on the one hand, and property and marketing costs on the other hand), and the total real estate expenses. The REER (*Real Estate Expense Ratio*), which is the ratio between these real estate expenses and the gross asset value, is also indicated;
- AMC 2: in the annual reports and/or the periodic information documents, management and administration fees are broken down into various categories, including an "*asset management and selling fees*" line.

Note that, for several funds, AMC 4 uses a single PM service provider for all the assets, but the identity of this service provider is not disclosed to the unitholders, even though this increases the risk of conflicts of interest, and using a single service provider results in greater dependence on that service provider.

Good practices:

- Disclose *ex ante* in the regulatory information documents information concerning the organisation adopted for AM and PM (scope of operations performed in-house and outsourced scope, procedures for selection of service providers, where applicable the possibility of outsourcing to one or more companies belonging to the same group, existence of conflicts of interest, etc.)⁵.
- In the case of SCPIs, specify whether AM and PM expenses, when these functions are delegated to a third-party service provider, are included in the management fee. Otherwise, indicate these expenses as part of the fees in addition to the management fee.⁵
- *Ex post* (in the annual reports or periodic information documents, for example), present information that is as precise as possible regarding the various categories of fees, notably to be able to identify fees relating to AM and PM services (whether they be received by the AMC or paid to third parties). Present these fees as an amount and as a percentage of the value of the assets and/or the rents collected.

Bad practice:

- For a given fund, using a single AM and/or PM service provider, without informing the unitholders of the service provider's identity.

3.5- CONFLICT OF INTEREST MANAGEMENT

➤ **Allowance for real estate services in the conflict of interest management system**

The selection of real estate service providers can be a source of potential conflicts of interest, due, for example, to the risk that the AMC might select a service provider forming part of its parent Group, for the sole purpose of promoting the group's interests. In practice, however, only AMCs 1, 2 and 5 use service providers that are members of their group (in the case of AMC 2, this concerns only the AM of one of the funds).

The six AMCs in the sample group have indeed set up a conflict of interest management system governing the selection of service providers (although without necessarily specifically targeting AM and PM).

In three of the six cases, however (AMCs 2, 3 and 4), this system was not fully operational in practice, insofar as the requests for proposal and/or consultations (which are the measure for supervising conflicts of interest) were not sufficiently traced, as explained in Part 3.2. Accordingly, the inspections were unable to ensure that the choice of service providers had been made based on factual and objective criteria, and in compliance with the procedure for selection of service providers.

➤ **Situations of conflicts of interest**

The inspections detected two situations of conflicts of interest which were not managed appropriately:

- For the assets held abroad by one of its funds, AMC 2 uses a company forming part of its parent Group for AM. However, the inspections found that:
 - the AMC was unable to explain the appropriateness of the choice of this "group" service provider, which was not subjected to competition;

⁵ Changes made to the regulatory documents along these lines, under the responsibility of the AMC, do not constitute material changes in the vehicle's strategy and/or investment policy, and therefore do not require a review by the AMF.

- the unitholders were informed of the name of this service provider, but not of the fact that it formed part of the same group as the AMC (note that the names of the AMC and the service provider give no indication of this).

For a request for proposal, AMC 4 preselected three PM service providers, including a company forming part of its parent Group. However, given the lack of sufficient traceability of the selection process, the inspections were unable to ensure that this selection had been performed on the basis of factual and objective criteria, and in compliance with the selection procedure. It should be noted, however, that at the date of the inspections, in practice, this "group" service provider performed no PM services for any asset.

➤ **Conclusion regarding conflicts of interest**

From a formal standpoint, the six AMCs have therefore suitably established a conflict of interest management system, with risk mapping of conflicts of interest including items relating to the selection of service providers. In practice, however, conflict of interest management is not always satisfactory, notably due to insufficient formalisation of the service provider selection processes, especially in the case of selection of service providers from the same group as the AMC.

Regulatory reminders:

- The AMC shall take all reasonable measures to identify conflicts of interest and prevent them from harming the interests of their funds and their unitholders. If, despite all the measures adopted, these conflicts of interest cannot be prevented, the AMC shall manage them and, where applicable, reveal them, to prevent them from harming the interests of their funds and their unitholders (Articles L. 533-10 of the Monetary and Financial Code, 318-13 and 319-3 of the AMF General Regulation and 30, 31, 33, 34, 35 and 36 of Delegated Regulation 231/2013).

Bad practice:

- Failure to sufficiently formalise factual and objective criteria, notably via competitive tendering, making it possible to prove the suitability of the choice of outside AM and/or PM service providers, especially in the case of one or more companies belonging to the same group.

3.6- CONTROL SYSTEM RELATING TO REAL ESTATE SERVICES

➤ **Permanent controls**

All the AMCs in the sample group (except AMC 2) have indeed set up second-level controls relating to the selection of service providers, fees and conflict of interest management. However, for AMCs 5 and 6, the control of expenses merely concerned subscription and management fees (which include AM in particular) and not expenses relating to PM service providers.

Also, the traceability of these various controls was not always sufficient. The control sheets were not always sufficiently precise (regarding the control objectives and procedures, the conclusions and any associated recommendations, etc.), and the AMCs were not always able to submit to the inspection task force the associated substantiating documents (audit trails and working documents of the controller).

➤ **Periodic control**

Since 2016, AMCs 2, 4, 5 and 6 have not performed or ensured the performance of any periodic control on the issues mentioned above.

Regarding AMC 1, periodic controls were performed on broader scopes of operation, without leading to recommendations concerning those issues. Lastly, in the case of AMC 3, controls were carried out on expenses and the selection of service providers, but the traceability of these controls is insufficient.

Regulatory reminders:

- The AMC shall establish, implement and keep operational appropriate internal control mechanisms, designed to guarantee compliance with the manager's decisions and procedures at all levels (Article 57.1 of Delegated Regulation (EU) No. 231/2013).
- The AMC shall establish and maintain a permanent and effective compliance verification function, which operates independently and controls and, at regular intervals, evaluates the appropriateness and effectiveness of the measures, policies and procedures, and the actions undertaken to correct any failure to fulfil their professional obligations (Article 61.2 (a) of Delegated Regulation (EU) No. 231/2013).

Bad practice:

- Not performing sufficiently precise formalised and traceable controls specifically concerning the fees relating to PM services.

APPENDIX – Pricing of AM and PM services

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5	AMC 6
AM pricing	<p>AM is insured, sometimes with the support of a third-party company.</p> <p>Generally, the AMC bills funds a % of the appraised value of buildings (0.13% to 0.25%), but this % in some cases also includes the fund management service.</p>	<p>AM is usually insured.</p> <p>Depending on the fund, the AMC charges between 0.5% and 0.7% of the asset value, or between 7% and 8% of rents invoiced and collected.</p> <p>For one fund, AM is outsourced. The service provider charges 10% of rents invoiced and collected.</p>	<p>These services are partially outsourced, and invoiced by the asset manager to the company owning the asset (and not the fund). Depending on the fund, invoicing is established as follows:</p> <ul style="list-style-type: none"> - % of the rent (4.3% or 8% depending on the building), with a minimum amount; - fixed amount, with a variable additional amount; - 0.3% of the market value of the buildings managed. <p>To these charges are added success fees if the IRR exceeds a predetermined threshold. In one of the funds, for example, if the IRR exceeds 15%, the amount of success fees will be 15% of the portion of free net cash flow, capped at €3.5m.</p>	<p>AM is insured.</p> <p>It is not covered by specific invoicing (the AMC is remunerated in management and administration fees, which cover AM among other things).</p>	<p>AM is insured (the company presents this as being work inherent in the investment in and divestment of a real estate asset by one of the funds), and is not covered by separate invoicing from other fees.</p>	<p>AM is mostly insured, and brokers are used for rental property marketing.</p> <p>The use of sales brokers is based on a standard mandate which is identical for all the brokers used by the company. This mandate provides for remuneration of the broker by the SCPI amounting to 10% to 15% (VAT extra) of the average annual rent excl. VAT and tenant's charges for the period of firm commitment in the case of a lease over 3 years, 6 years or 9 years. This fee is shared 50/50 between the lessee and the lessor. It is paid by the SCPI.</p>

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5	AMC 6
PM pricing	<p>PM is usually outsourced.</p> <p>Service providers send their invoices to the fund (or to the company owning the assets) or to the AMC (which then re-invoices), on the basis of a % of the rents (from 3.6% to 5.7% of rents excluding VAT).</p> <p>In some cases, the service provider may send additional invoices for other services not included in this % (marketing or work supervision, for example).</p>	<p>For rental management, the AMC charges the funds 0.3% of the rents invoiced.</p> <p>For technical management, service providers work sometimes on a fixed-price basis, but usually for a % of rents: 1.3% to 3.5% of rents (invoiced or collected rents depending on the case).</p>	<p>PM is outsourced.</p> <p>Depending on the fund, invoicing is established as follows:</p> <ul style="list-style-type: none"> - % of rents invoiced (0.55% or 3% depending on the building), with a minimum amount; - fixed amount; - 1.5% of the invoiced rent; - €2.7 per square metre. 	<p>PM is outsourced.</p> <p>The services are invoiced by the PM quarterly to the real estate company owning the asset. This invoicing is usually on a fixed-price basis.</p> <p>For one of the funds, however, invoicing is based on a % of revenues collected (rental management):</p> <ul style="list-style-type: none"> - between 0.2% and 0.225% excluding VAT (depending on the surface area) for rental management; - between 1.80% and 2.025% excluding VAT (ditto) for administrative and technical, accounting, financial and legal management. 	<p>PM is partly outsourced. The pricing conditions for real estate services vary depending on the type of service and the service provider.</p> <p>For technical management mandates: The service provider's remuneration consists of an annual lump sum excluding VAT for the technical management / day-to-day management part. Technical managers do not all have the same duties, which depend on the building's level of equipment and services (caretaker, heating, floor space, etc.). For example, the invoice for technical management of a building without any particular services will be in a range between €1.7 and €3.5 per m². A shopping mall, meanwhile, will be invoiced at €8.80/m². On the other hand, additional duties such as management of damage and structural insurance claims, litigation management or works</p>	<p>For the technical management and work performance part, PM is outsourced.</p> <p>Generally, technical management services are invoiced to the SCPI on the basis of an amount per m², determined according to the type of works to be performed (e.g., change of carpets, change of false ceilings, compartmentalising / decompartmentalising of work areas, etc.).</p> <p>More specifically, the remuneration clauses of agreements entered into between the technical management service provider and the AMC generally include prices per m² for each type of building (occupied, vacant, single-tenant, condominium, etc.) for the technical management part and works supervision fees (for example, 8% excluding VAT for works amounting to between €2,000 and €8,000, 6% excluding VAT for work amounting to between</p>

					<p>performance are invoiced on an hourly fee basis or as a fixed % of the cost of the works.</p> <p>For rental marketing mandates: The mandates mention remuneration on the basis of maximum fees equal to 30% excluding VAT of the annual average of invoiced rents excluding VAT and excluding charges over the first three-year period.</p> <p>For works performance mandates: Invoicing is performed on the basis of a unit price excluding VAT per m² varying depending on the nature of the works to be performed and in a price range between €250 and €350 per m². Note that these prices vary greatly from one service provider to another and from one type of real estate asset to another, making any comparison relatively irrelevant.</p> <p>These services are invoiced directly to the SCPI and re-invoiced to the tenants of the real estate assets for which the services were performed.</p>	<p>€15,001 and €45,000, etc.).</p> <p>These services are invoiced directly to the SCPI and re-invoiced to the tenants of the real estate assets for which the services were performed.</p>
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