Chicago – November 10th, 2016

NAREIM LEGAL & COMPLIANCE MEETING

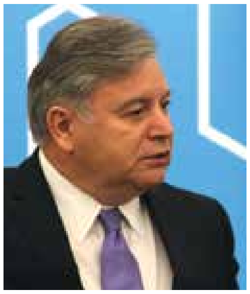
NAREIM

National Association
of Real Estate Investment Managers

NAREIM Legal & Compliance Meeting – November 10th, 2016

WHAT DO WE DO NOW?

"For every complex problem there is a simple solution, that is wrong"
– George Bernard Shaw

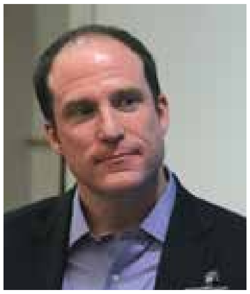


"The Inverted Yield Curve has most accurately predicted the last 7 recessions."

Will McIntosh
Global Head of Research for USAA

The day after the U.S. presidential election, NAREIM legal & compliance officers gathered in Chicago to discuss the evolving legal and regulatory landscape. Surrounded in the streets around the meeting, thousands of protestors had spontaneously gathered to protest the surprising results of the vote held 24 hours before. Regardless of the political leanings of any attendee, there was a consensus in the room that this was an unexpected outcome – and that the challenge of the months ahead will be to adjust to a new and unforeseen political and regulatory landscape.

Real estate investing is fundamentally about predicting the future, and the election demonstrated quite clearly how difficult it is to create certainty about the future, "How many times do we have to re-learn the lesson that we can't be certain about any future event," asked Gunnar Branson of NAREIM, "especially in politics. But that doesn't mean we should stop looking forward. We all have to understand what is actually happening right now, not just what we wish was happening. If we see it clearly enough, there may be fewer surprises in the future, and perhaps we can even respond more intelligently to those things that upset the status quo."



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Matt Campbell
SVP, Legal,
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Group CCO for Bentall Kennedy

What do we do now?

"There are historical fundamentals that might help us understand what could happen," said Will McIntosh, Global Head of Research for USAA, "The new president has laid out a platform with key initiatives that could impact the economy both positively and negatively." The initial reaction from markets might have been negative, but it did not last long. "The stock market came back with a vengeance. However the 10 year treasury finished at 2.07. They are pricing in an expectation of inflation." Interest rate volatility is a major concern and this points to it rising. "He's talking about building infrastructure, boosting jobs, lowering taxes, and repatriating corporate funds held offshore." All these comments suggest that there will be inflationary pressure. The federal target for inflation is 2%. "If all these things happen, there is a good chance we will blow way past that." Would a rising inflation environment be bad news for real estate investing? Perhaps not. "It has always been a great hedge against inflation."

"The Inverted Yield Curve has most accurately predicted the last 7 recessions," claims McIntosh. "Where the short term rates get higher than the long term rates. If the ten year treasury hovers at 150 basis points and the FED wants to move the federal funds rate up incrementally over the next year or so to 200 basis points, you're getting into that inverted environment." When the yield curve inverts, a recession tends to happen within 12-18 months. "The ten-year is moving finally which is good, because I'd rather not have a recession if we can avoid it."

So what does this mean for the real estate environment? "If you believe that rates are going up, and I do," said McIntosh, "it's going to get increasingly difficult to finance these deals." The amount of transaction this year may only be down by approximately 10% compared to the previous year but "people used to get 14 bids on a deal where now they're only getting three or four. Two of which are real." The level of foreign investment is another area to watch. The majority of real estate investment managers have a significant amount of foreign capital in their funds. "I think foreign money is going to slow down very quickly as they adopt a 'wait and see' policy." A hostile trade and immigration policy, increased barriers to non-US companies, and international currency volatility could put a significant crimp in the flow of non-US capital. But just like the stock market reaction in November, there is a possibility that non-US capital will return to American real estate investments quickly. "Where else are they going to put their money? Germany and Japan are looking at negative interest rates. The US is still fairly stable."

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Ron Jacobs
Chair of Political Law Practice for Venable, LLP

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Joan Meyer
Partner at Practice Chair Compliance, Investigations and Government Enforcement

How should investment managers approach political corruption?

A discussion planned long before the election was electrified by the emotional and sometimes vitriolic election season. How should managers approach anti-corruption policies? One approach is to disengage completely, "We do a lot of business with state pension plans so we just made an across the board policy that prohibits all political donations," said Matt Campbell, SVP, Legal, Canadian General Council and Group Chief Compliance Officer for Bentall Kennedy. But there are other, more flexible approaches to consider.

"The way to have a successful policy is to think about what is important to your company and who the employees are. If you ban political contributions across the board for a company full of politically active employees, you're going to have a bunch of unhappy people," said Ron Jacobs, Chair of Political Law Practice for Venable, LLP. Depending on where a company's interests lie and with whom one does business, it's possible to create a custom policy that allows for political involvement and helps make clear where the conflicts of interest might lie. "One approach might be to characterize political risk as three simple colors: red, yellow, and green, just like a traffic light. If you have active interest in a state, the stop light should be red for political involvement. If you have no interest in a state whatsoever, consider it green. And if there is some interest or maybe future interest for investing in a state, that would be yellow: tread, but tread lightly."

"There has to be a semi-annual, or annual reporting requirement," pointed out Joan Meyer, Partner at Practice Chair Compliance, Investigations and Government Enforcement, "There should also be some executive oversight as to how contributions are being used." The rules around political contributions and conflicts of interest are incredibly complicated. "If you're using a third party or contributing through a PAC, you're going to need to know what they are doing and who else is donating into that pool." A current or perspective employee's track record with political contribution can pose a serious risk of exposure, so it's essential that political activity is a key part of all due diligence no matter what.

How will the new administration affect the SEC?

"After the Romney campaign, the SEC essentially decided they were going to vilify private equity," pointed out Eva Ciko Carman, Partner at Ropes & Gray. "From the SEC's perspective we are all private equity of one sort or anther." What constitutes a conflict of interest can be very counter intuitive. "If your disclosures allow for deal sourcing travel but don't specify what type of travel, private jets will be assumed to be a breach." Unless it is explicitly stated in the contract, you have to err on the side of what benefits the investor.

"Most investigators understand equity securities. Some of them understand debt securities, but for the most part they do not understand real estate," claims Stephanie Monaco, Partner, Corporate & Securities at Mayer Brown. "It is not a class they can easily review so they borrow from equity procedures."

The SEC has been cracking down on the real estate sector with such abandon that it is hard to believe they are doing it for our own good, or for the good of the investors. "It seems to me that they are doing it to find cases and that makes me very sad," said Monaco.

"My hope is that we will see some real regulation as opposed to enforcement going forward," said Carman. The ramp up of enforcement has been drastic. There have been a number of cases recently that would not have been a problem five or six years ago. "I think it has been unproductive for the industry on the whole and it's unfair for the people in this room. However, I think we might see better regulation in the future that could be a little less aggressive on the enforcement side."

"The SEC is very concerned with hiring people who have prior disciplinary actions," said Monaco. There are standard requirements that everyone must abide by but, "for reputational purposes you might want to know a little bit more. If someone gets a DUI in the states it's not really a disclosure item. However, if someone gets a DUI in the UK, it is. If you employ someone that has been involved in a major civil case, you have to decide if that is relevant and material to whether they should be able to manage investments or not."

As is becoming standard practice in many facets of the commercial real estate world, the benchmarks, rules, and regulations used in Europe are migrating to the US. In an increasingly international business environment, the need to level the playing field, or at least to make sure we are just as attractive to foreign investment as anyone else, is important.

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Partner at Dechert

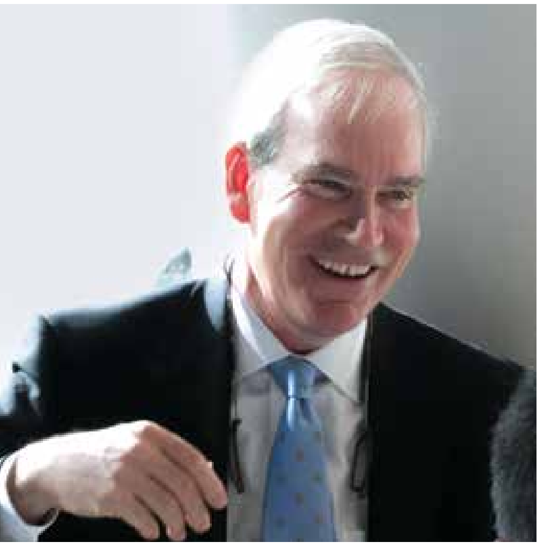
How will Brexit affect Commercial Real Estate?

Brexit may play out in a number of ways, "One is a 'Hard Brexit' that essentially says, 'You're out, and you can negotiate trade deals the same as Canada, The US or any other independent country," according to Glynn Barwick, Council for Goodwin Proctor. Or there is a "Soft Brexit" that allows for "continuing participation in the single market and maintaining the EU policies that go with it i.e. free movement of capital and labor. Which effectively keeps the UK in the EU." But that is a big part of the reason a majority voted to exit the EU in the first place.

"One of the biggest political issues that lead to Brexit was immigration," explained Chris Christian, Partner at Dechert. "So for the UK to turn around and agree to free movement of people would be dicey." So it's likely to be closer to a hard Brexit. "Where does that leave us?"

When trying to sell services in London there are typically two issues to consider, "one issue is product registration, or does the product itself need to be registered in order for me to raise capital," said Christian. "The second is what we think of in the US as broker/dealer licensing. Do I need to be licensed to sell and provide investment advice." Providing investment advice, "that's a regulated activity. So if your group is based out of London, you're going to lose that." They will no longer be able to fly around the EU and make those sales. "If you have European funds that are liquid, and you utilize a distributor in the UK to sell those, you will lose that ability as well."

According to Christian, there are only a few ways to deal with this: "Option one, through negotiation the UK will get equivalency which essentially means no change and a grandfather clause for all existing deals. The second option is, you can move your organizational people to other offices you might have in the EU. Third, perhaps you build a new brick and mortar in Frankfurt, Ireland, Luxumburg. Fourth option is you can hang your license with somebody else that will chaperone you and look after your sales team."



"British people are notoriously monoglot."

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Council for Goodwin Proctor

"We have seen a bit of the last option taking place because there are a lot fund managers that want access to European investors but don't want to go through the registration in each and every country," said Barwick. However he does not believe that there will be a mass migration of financial services personal out of London. "Other major cities in Europe simply can't support it, and British people are notoriously monoglot." There is however what is called a "third country" series of procedures that allows business to continue with the EU even though the UK is no longer part of it. "Our hope is that these procedures become workable."

The biggest unknown is what happens in five or ten years when new agreements are negotiated and the UK is not part of the proceedings. "Who knows what that directive is going to look like? These agreements might not be so effective then," warns Barwick.

We talk about change a lot at NAREIM, but in the days following a contentious and startling U.S. election, there never seemed to be so much of it. With major shifts in the US, in the UK, and indeed across the globe, uncertainty is the standard. To be resilient and successful in this brave new world we need to have all our wits about us, be able to adjust thinking, and act courageously. There are no simple solutions for the challenges we face, only complexity and change. Stay sharp and keep asking questions – the years to come will be an interesting adventure.

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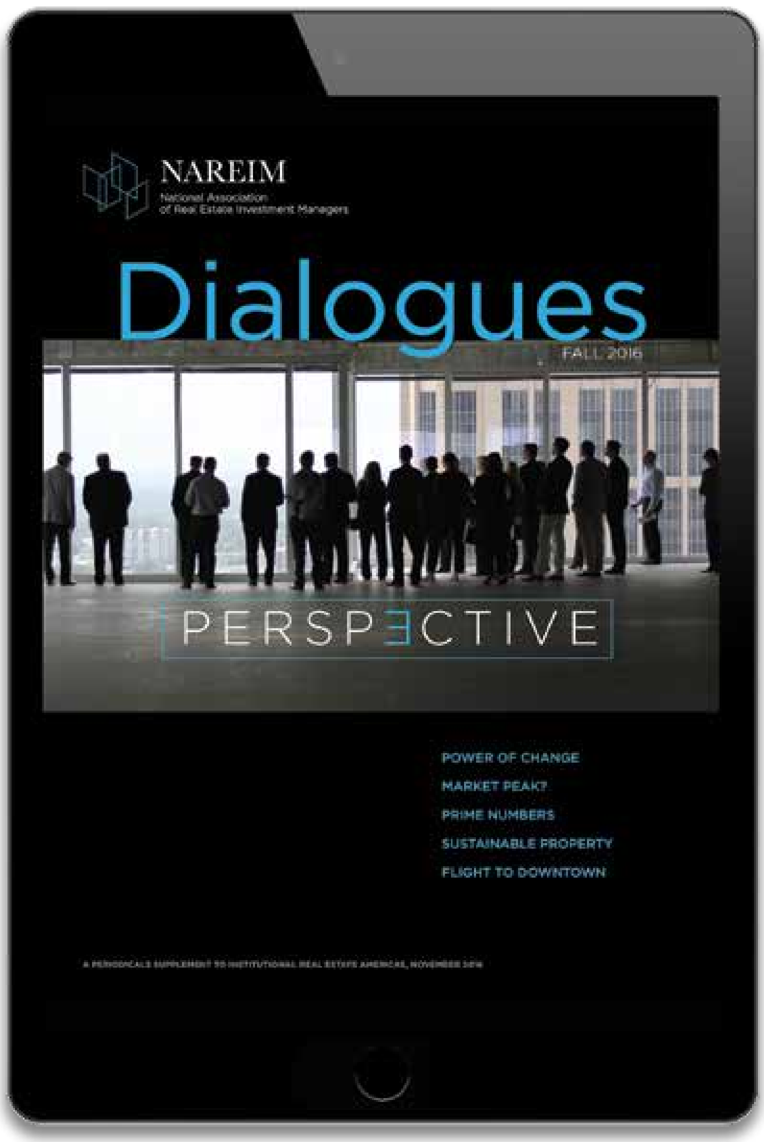
NAREIM Dialogues Magazine



ABOUT NAREIM

The National Association of Real Estate Investment Managers (NAREIM) provides members the opportunity to refine strategy, improve operations, and provoke new thinking through meetings, surveys and thought leadership activities.

NAREIM members manage investment capital on behalf of third party investors in commercial real estate assets such as office, retail, multi-family, industrial and hotels. Collectively, NAREIM members manage over a trillion dollars of investments assets.

NAREIM members invest in office, retail, multi-family, industrial and hotels. Investment is made throughout the "capital stack" meaning that investments are made both in equity positions (direct ownership) and debt (first and subordinate mortgages). In the debt sector, investment managers have platforms to buy existing debt (mortgages and other instruments such as mezzanine and CMBS) and to make private equity financed loans.

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