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European Real Estate Asset Manager Benchmarking Survey 2016

In this study we give an overview of the leading operating models in European real estate asset or fund management.

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By Jürgen Buchelt

With Susanne Eickermann-Riepe, Annett Anschütz und David Nadge

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The information contained in this publication was intended for our clients and correct to the best of the authors' knowledge at the time of publication. Before making any decision or taking any action, you should consult the sources or contacts listed here. The opinions reflected are those of the authors.

Due to rounding differences the individual values displayed in the figures of this report may not always sum up to the total of 100%.

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A Executive Summary

This report includes a survey on the organisational setup of European real estate asset management, or fund management. It presents the current state of an industry that is believed to benefit from a massive potential for growth over the next couple of years. We have found it to be an industry on the brink of becoming part of a global market, with the potential to become more efficient and to advance its digital capabilities.

Local champions with global aspirations?

The most promising sources of capital and real estate performance for the near future will sit outside of Europe. In order to access the groups of investors and property markets that will enable the envisaged growth, asset managers need to expand their operations outside of their European home turf much faster than ever before. Our survey, however, indicates that many managers are at the very beginning of this journey, if they have even embarked on it at all. A long road lies ahead of many of those targeting a significant share (25% or higher) of equity raised, investment activities, and people on the ground outside of Europe. There is a strong home bias in the industry which must be transformed into a source of global growth.

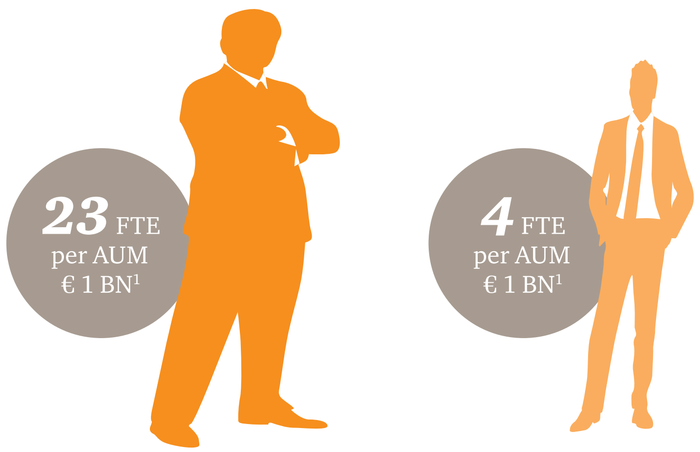
86% *of clients come from Europe*

88% *of employees in Europe*

91% *of assets under managements in Europe*

Too tight or too tall?

Growth in assets under management and revenues will be driven first and foremost by front office operations such as product management, sales and property investment. As this survey shows, the starting position is anything but ideal. Also, as a result of our survey, we are concerned that the “at home” setup of certain parts of the industry is less efficient than it could be for generating the necessary cash flows for investments in international expansion or new business models. In fact, we see a strong spread in workforce efficiency measured simply by the relation between employees and assets under management.



Be more agile and efficient!

While front offices seem to face challenges in becoming an efficient and digitally advanced driver of international growth, back offices today appear to be the Area 51 of the real estate industry for testing new industrial approaches. Our survey reveals that managers are transforming different parts of the value chain by outsourcing. It also appears that companies shadow their external managers to differing extents. At the same time, managers are speeding up their reporting and accounting processes to meet increased investor demand. Our survey shows that managers from France and Luxembourg are ahead when it comes to outsourcing.

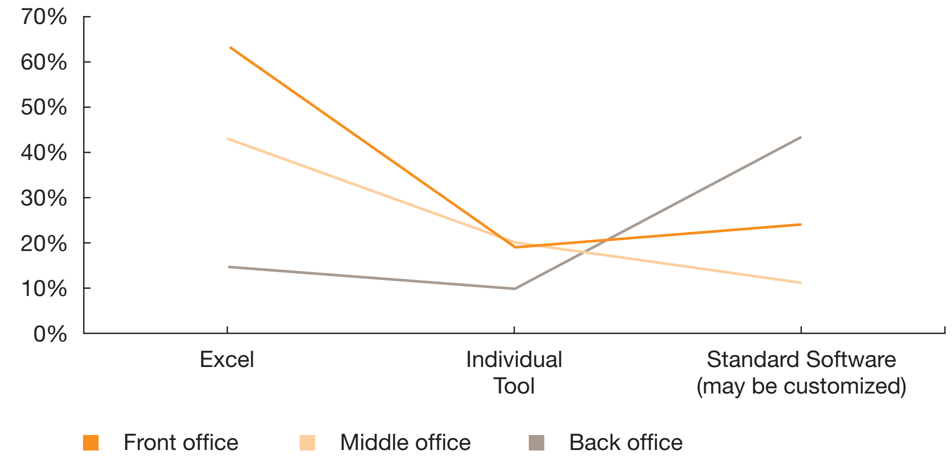
“The Germans have created the Autobahns of the back offices.”

Digital transformation to hit the front office

The front office is an area where, in future, we will see increased investments in client relation management and digital distribution, business intelligence, process automation and new interfaces, for instance web-based leasing platforms. In fact, we find that front and middle offices today tend to lack individual tools or standard software. Instead, they rely heavily on a flexible Microsoft Excel environment. 62% say that Microsoft Excel is their standard front office software.

[1] Asset managers with AUM € 10 Bn or more

What software is used for front, middle and back operations?

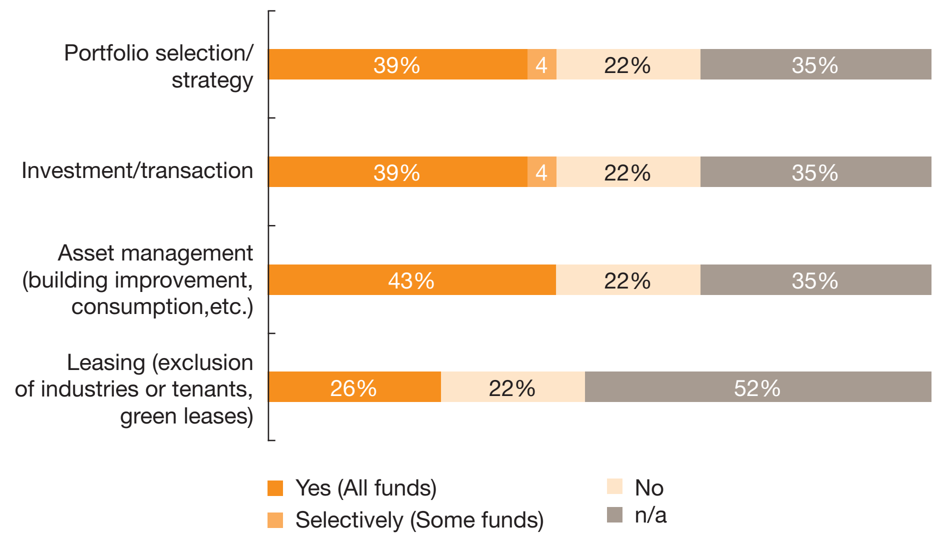


Among many useful insights that make this survey a unique source of benchmarks for any CEO, CFO or COO, there is one further finding of importance and a good example of the depth of this report that we would like to highlight in this summary.

Are the important problems really being solved?

Despite being frequently named a top management priority and one of the key value drivers for the future, greater effort must be devoted to implementing responsible investment in the core processes of asset management. For instance, the Principles for Responsible Investment have yet to be implemented by the majority of participants.

Have PRI policies been implemented?



We believe that this survey is a useful tool for any manager who wishes to further advance their business and to take their operations to the next level of industrial strength. There is a world of opportunities out there!

B About this survey

We would like to offer our sincere thanks to all the participants – who remain anonymous – for their time and patience with the extensive questionnaire. We would also like to thank all the PwC colleagues who have made this survey possible.

We are committed to providing market participants in the asset management sector with insights and inspiration, and thus we are hoping for a high level of participation in the next survey too. You are cordially invited to participate!

1 The purpose of this survey

Having initiated a benchmark survey for European real estate asset managers for the first time last year, we are pleased to present a second European Real Estate Asset Manager Benchmarking Survey this year.

We started our transnational benchmarking survey among leading investment and asset managers in the main markets of Europe in the autumn of 2015. With a total of 23 real estate asset managers participating, the survey represents a significant section of the industry, with around €230 billion assets under management.

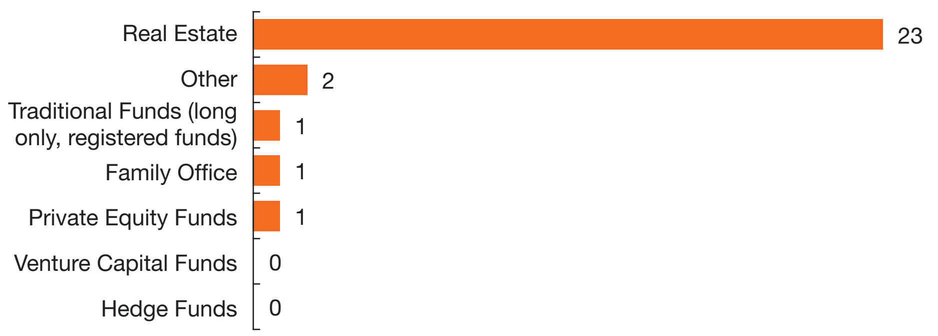
In the course of our survey, we asked the participants extensive questions about their organisational structures, governance, products, operations, service providers, appraisal processes and reporting. The result is a 72-page survey which will enable asset managers not only to compare themselves with their peers around the world but also to recognise trends and leading management approaches. This analysis makes it possible to reliably extract valuable findings regarding one's own position in various fields of comparison to the competition. The results of this survey are presented on the following pages.

In view of the number of participants, the types of products and the exclusive focus on the main European markets, it should be noted that the findings described here are not statistically representative. However, as one of the few known sources for organisational comparisons, these results provide seminal insights and are important for the further development of the industry.

2 The participants

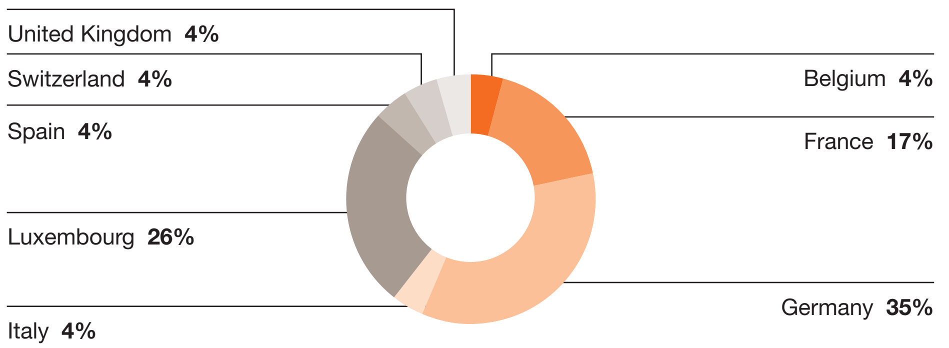
For this year's edition of the European Real Estate Asset Manager Benchmarking Survey, we invited the leading real estate asset managers in Europe to participate – and received a great response! The 23 participants from the leading European markets represent assets under management ("AuM") of more than €230 billion. In comparison to the previous year, this represents an increase of 50% and is indicative of the increasing relevance of the survey.

Fig. 1 Which of the following industry segments does the manager participate in



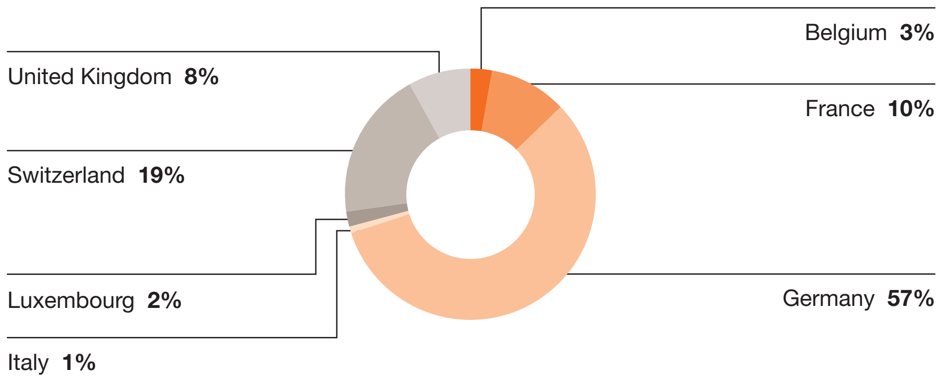
The greatest common factor among participants is the industry in which they work: all are active in real estate asset management. In comparison to the previous year, only a few responses name other segments.

Fig. 2 What is the company seat of the participants?



As in the previous year, German asset managers represent the largest group of participants, followed by France and Luxembourg.

Fig. 3 What is the company seat of the participants scaled by AuM?



An analysis of the AuM according to the participants' home country sees Switzerland come to the fore as a traditionally significant asset management location. There is a noticeable dominance of the German fund sector in the survey.

Most of the participants employ between 25 and 250 people, whilst only 22% of the participants have more than 250 employees. Together, these two groups manage 99% of the AuM.

Fig. 4 How many FTE do the manager/advisor employ overall?

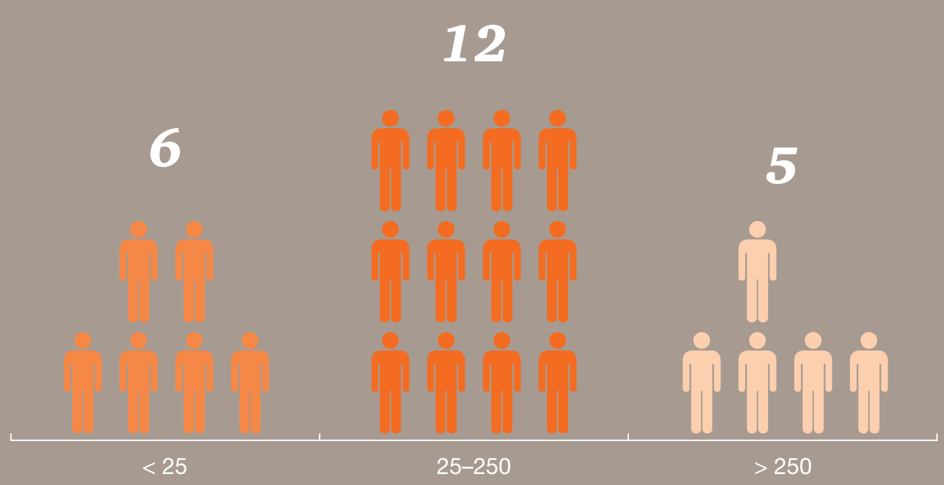
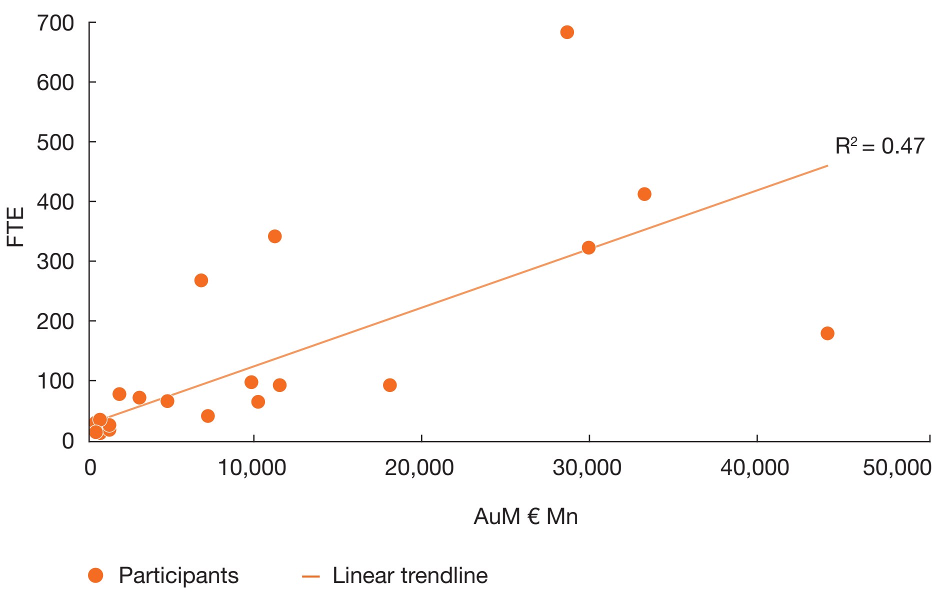


Fig. 5 What is the relation between FTE and AuM of a manager?



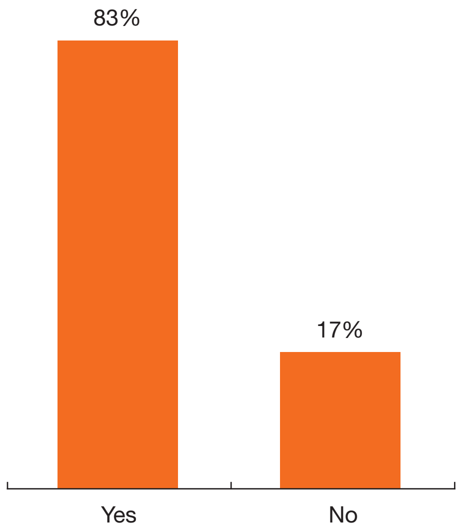
The graph explores the relationship between the number of employees and the size of the asset manager measured in AuM. As expected, the correlation of these two parameters is clearly positive, with a correlation coefficient of 0.68. A trend line, however, can only be established with a low coefficient of determination ($R^2 = 0.47$). In other words, although the AuM are presumably a very significant cost driver, there is no strong indication of a mathematical relation at this level.

We assume that the reasons for this are to be found in the various operating models of the European asset managers. This conclusion very much fits the purpose of the survey: the existence of heterogeneous operating models indicates that there is much to be learnt from one another.

3 AIFMD has finally arrived

The picture painted by the group of participants is very consistent with regard to regulation. The Alternative Investment Fund Managers Directive (AIFMD) has arrived in the industry and few asset managers can evade the regulatory pressure. In comparison to the previous year, the percentage of non-regulated managers in the survey has fallen by 30% to 17%.

Fig. 6 Is the manager/advisor a regulated entity?



Nearly 70% of respondents also cite Alternative Investment Fund Manager (AIFM) as a business model, whilst the remaining participants are spread over insurance companies and other asset managers. Contrary to the responses received, there were no true corporate real estate managers among the participants.

Fig. 7 What describes best the business model of manager/advisor?

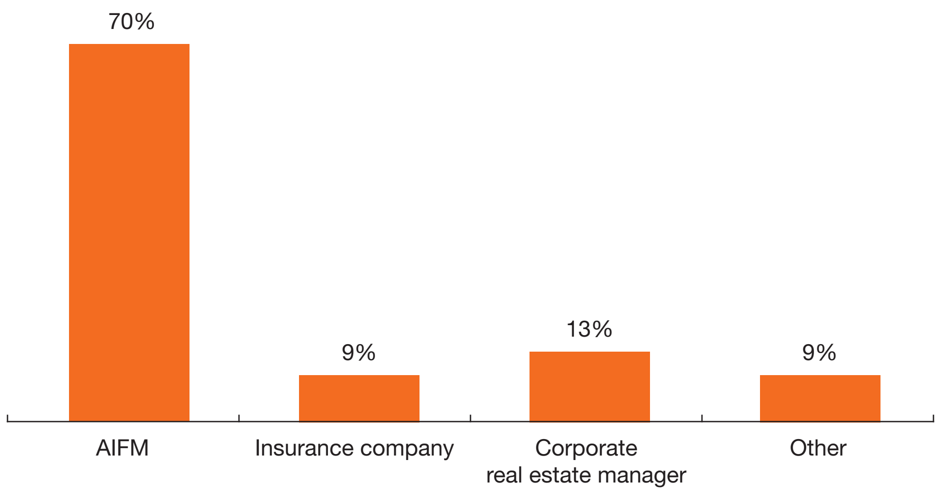


Fig. 8 How many fund domiciles does the manager operate?

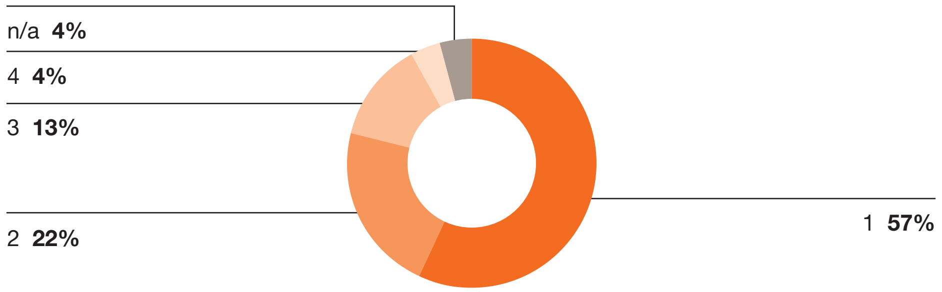
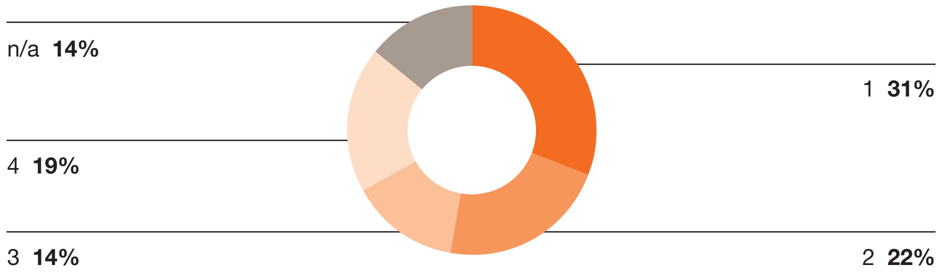
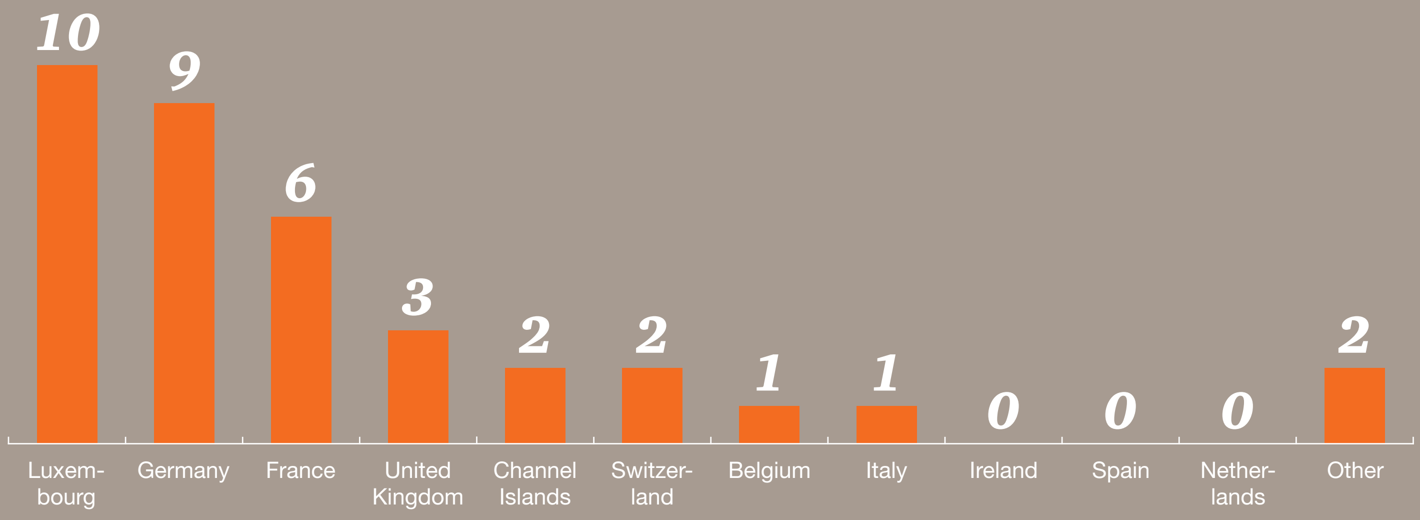


Fig. 9 How many fund domiciles does the manager operate, scaled by AuM?



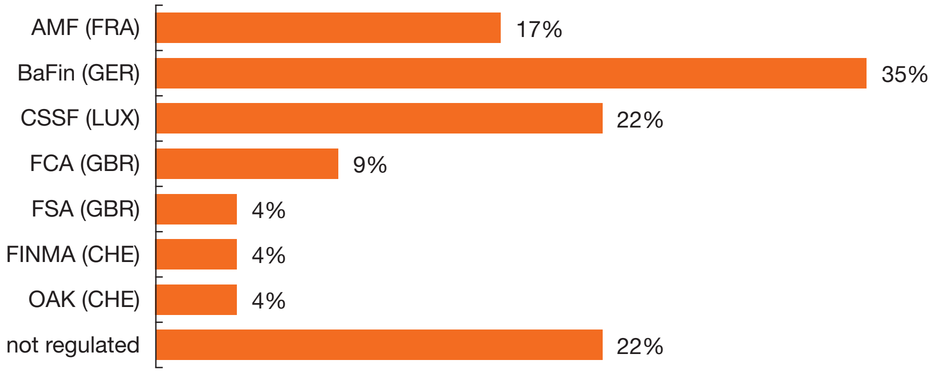
The graphs above show that our group of participants is not yet taking full advantage of EU passporting opportunities. Only 56% of the participants are satisfied with one fund domicile. To be more explicit, around 55% of the AuM are administered by managers with two or more fund domiciles.

Fig. 10 What is the domicile of the manager/advisor's funds?



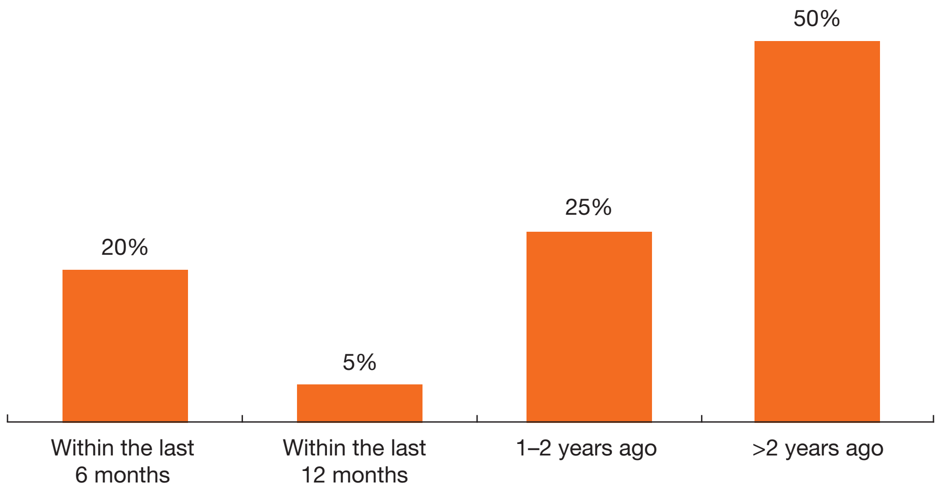
The quintessential European picture is apparent in our peer group too when it comes to fund domiciles – at least for the mainland: Luxembourg heads the list of fund domiciles, followed by Germany and France.

Fig. 11 Who is the main regulatory body?



Unsurprisingly, the BaFin, AMF and CSSF are the most frequently named under the respective regulatory bodies.

Fig. 12 When was the last time the advisor was reviewed by the regulatory body?



What is surprising, however, in comparison to the previous year, is that only 25% of the asset managers surveyed were subject to a review by the respective regulatory body within the last 12 months. In the preceding year, more than 50% were. Are Europe's regulatory bodies overburdened with the large number of new AIFMs or is there a high degree of trust in the compliance of the freshly licensed fund industry? The answer may well be provided in next year's survey.

C Trends on radar

"There is nothing permanent except change" Heraclitus

PwC is already carrying out a large number of surveys to identify which trends will have a profound impact on investment behaviour and the development of the real estate industry. With regard to this benchmarking survey and its focus on the operating model, i.e., organisation, processes and systems, our interest is focused in particular on four action fields: "International growth", "Institutional quality and industrial strength", "Build, buy or borrow" and "War for talents". All four action fields are closely linked with each other and are explained in more detail below.

Globalisation and cross-border investment activities were named by survey participants as the most important drivers in terms of remaining competitive and securing consistent and sustainable growth. Because of the low-interest environment, we are currently experiencing a huge glut of debt and equity on financial marketplaces. Likewise, it is also becoming apparent that the markets are increasingly growing together. The best example of this is Europe, following the recent implementation of European laws and standards. The number of requirements and expectations coming from legislators and investors is consistently growing, putting sustained pressure on margins and administrative costs.

The real estate sector, which in the past was considered to be unsophisticated, highly manual and insufficiently automated, is now transforming itself into an industry with more efficient and standardised processes. This trend is being underpinned by the rising number of service providers who – alongside their services for securities in the middle and back office – are also expanding to cover the real estate sectors. Even if we are currently at the start of a trend reversal, further far-reaching changes can be expected in the course of ongoing digitalisation.

1 International growth

According to the PwC survey "Alternative asset management 2020: Fast forward to centre stage"[2], a rise of up to $13.6 trillion (high-case scenario: $15.3 trillion) is forecast for alternative investment assets between 2015 and 2020. Globally, growth in AuM will take place primarily in the SAAAME countries (South Africa, Asia, Africa and the Middle East) rather than in the "more mature" markets. The trigger for the forecast development is the emergence of 21 new state investors, the majority of which will originate from the SAAAME states.

Growth will continue to increase until 2020, driven by three main trends: government incentives to shift to individual pension plans, an increase in the number of high-net-worth individuals in dynamic emerging markets, and the growth of state investors.

Growth rates will be higher outside of Europe than in the traditional markets of the European asset managers. Driven by dynamic economic growth and, particularly in emerging markets, a rise in expenditure on retirement provisions, the demand for both real estate products and the real estate markets themselves will increase in these growth regions. Asset managers are frequently being advised to intensify both fundraising and their investment activities outside of Europe. For this, they need local employees. As a result, we would therefore expect the customer base, the investment portfolio and the asset managers' employees to become increasingly international from year to year.

In the course of our survey, we have been able to establish that there are at least initial signs of this development. Some 86% of the investors come from Europe, with 74% of these coming from the domestic markets of the survey participants. Around 4% of the investors come from the US.

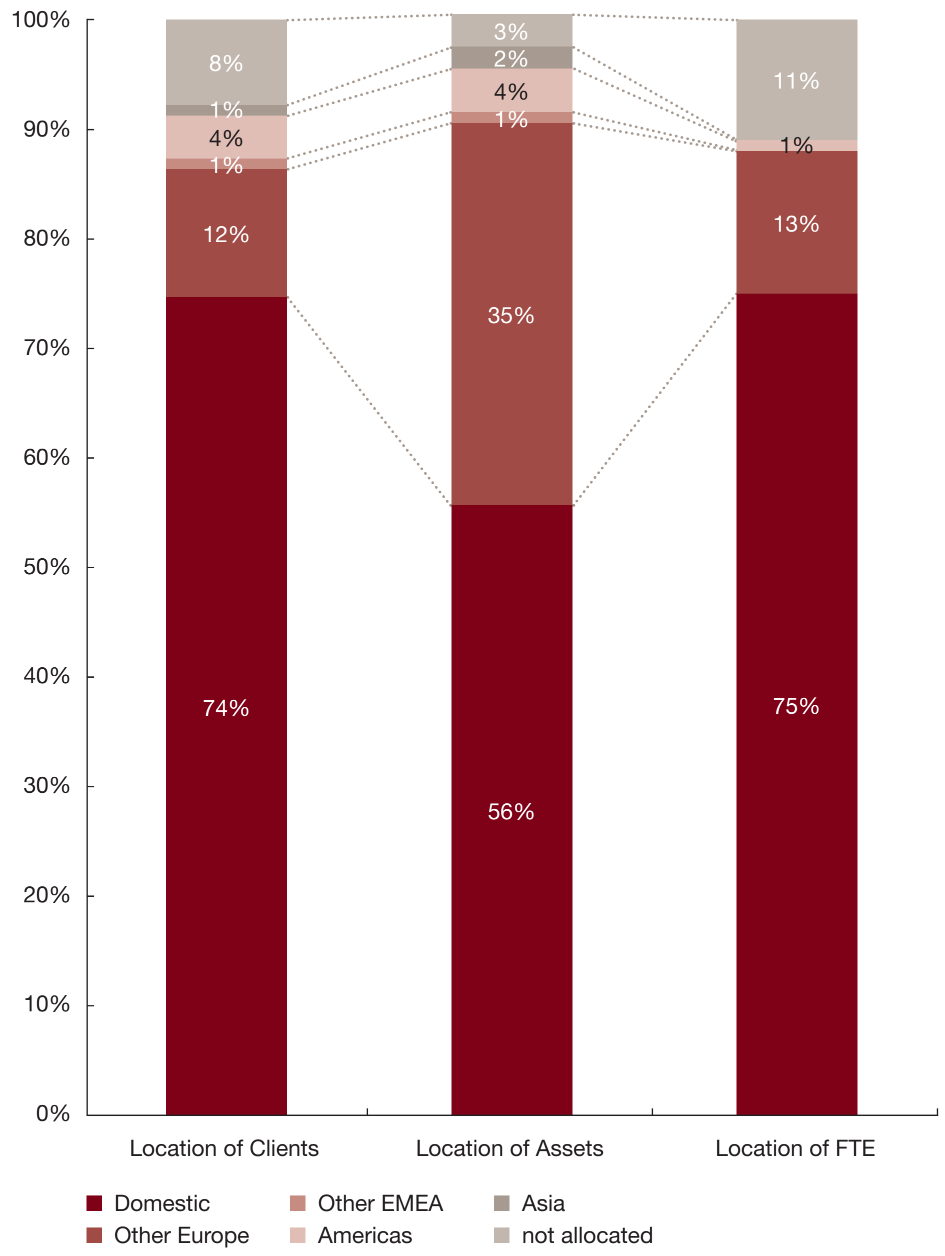
More than 90% of the AuM are still located in Europe. Of these, 56% are invested in the respective domestic market and 35% elsewhere in Europe. In the Americas, the US, as the largest real estate market worldwide, is the first port of call outside of Europe.

What is even more telling is that over 75% of the employees are based in the domestic market, with a further 13% based in other parts of Europe. Allocation is not possible for 11%, i.e., the percentage of employees in growth regions outside of Europe is hardly measurable today.

As a result, it is clear that the European market as a whole, outside of the individual domestic markets, is still a largely undeveloped growth field for a large number of asset managers. Customers, assets and employees are all predominantly located in the domestic market. The baseline of asset managers will not suffice to achieve a growth rate at, or above, average, nor will it be possible to maintain competitiveness unless great effort is rigorously invested into becoming more international. Having employees or partners on site in the growth regions is a precondition for being able to invest customer funds from Europe in a given region, raise funds in that region or – as a third move – establish self-supporting business models in the growth region.

[2] http://www.pwc.com/gx/en/industries/financial-services/asset-management/publications/alternative-asset-management-2020.html

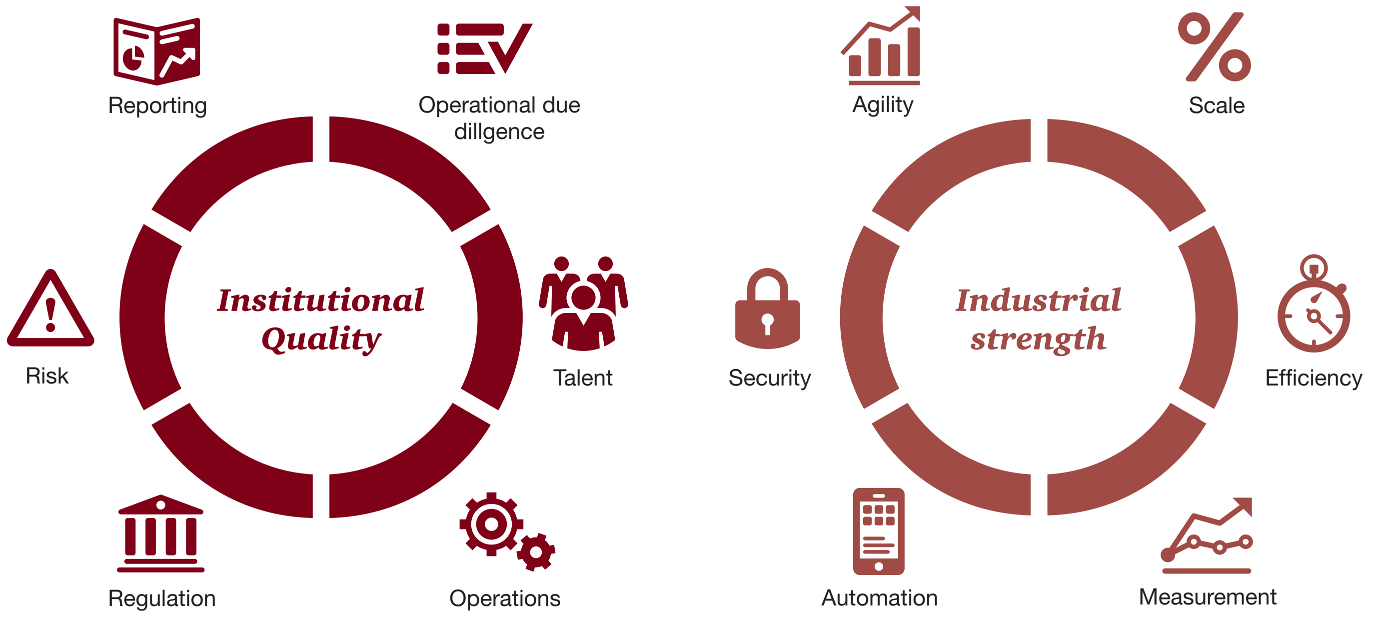
Fig. 13 How international are clients, assets and FTE?



2 Institutional quality and industrial strength

The growth strategy of an alternative asset manager should be supported by progression from institutional quality to industrial strength along with a careful choice of distribution channels. Both are prerequisites for the necessary funds and skills for growth.

Fig. 14 From institutional quality to industrial strength – What the industry needs to address rather sooner than later



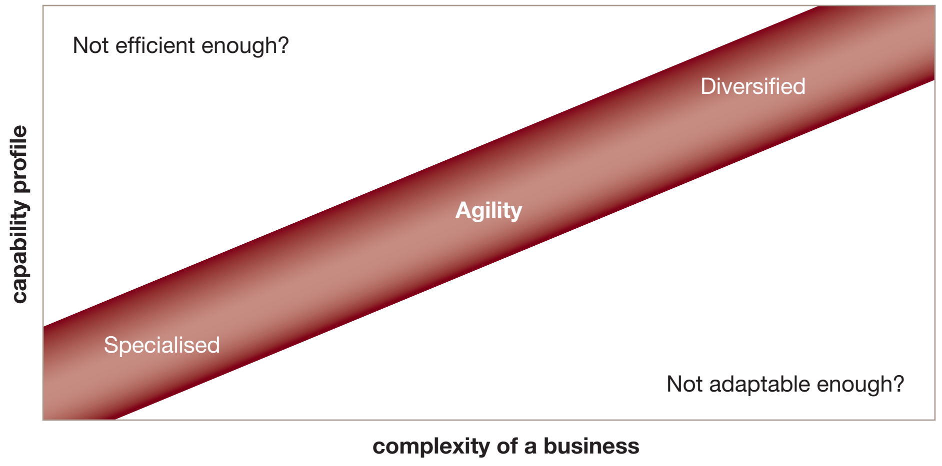
If we take a look at successful companies in the manufacturing sector, they excel by being able to easily adapt to changes in products and production levels, and to do so cost-efficiently and without disrupting operational procedures. Likewise, in future, alternative asset management companies will need to prepare themselves adequately to be able to adapt to changes in their product portfolios and performance ranges. The question asset managers will increasingly be confronted with is how to adapt their target operation model (TOM) in order to be able to provide tailor-made solutions for their (institutional) customers, support for new asset classes, products and investors, while at the same time being able to keep up with regulatory and control requirements. The challenge here is to be able to do this cost-efficiently and without disrupting day-to-day business whilst making a profit at the same time.

As suggested in the PwC survey "Alternative asset management 2020: Fast forward to centre stage", owners, investors and regulators will have to raise their expectations above the standard of "institutional quality". In conformity with the last regulatory demands of the AIFMD, most alternative asset management companies have already taken this step and institutionalised their business as far as possible.

At the same time, growth drives the complexity of the business model with new distribution channels and customer demands, target markets, cultures and price models, and calls for a coordinated capability profile. In response, both diversified and specialised companies have to demonstrate a sensible level of agility.

The capability profile gives an overview of available operative skills (e.g., operating model) and in-house competences, as well as the degree of automation and the service providers. It is a suitable tool for managers and can be managed proactively. By overlaying the capability profile with the complexity profile (as shown in figure 15), companies can establish for themselves the right degree of agility required in order to take a strategic growth path and manage the opportunities and risks it entails.

Fig. 15 Defining the right amount of agility for a business

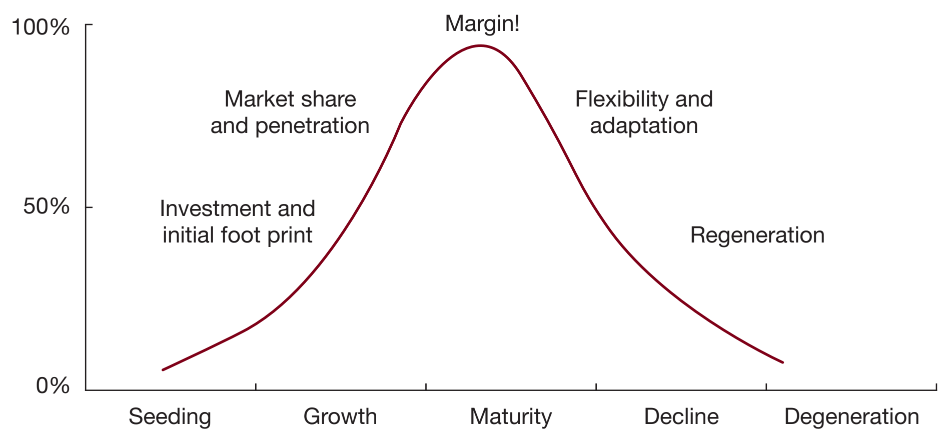


3 Build, buy or borrow

Differentiation, relationships and branding are central components of the business strategy of companies in the alternative investment sector. Major decisions during the installation of a business model are influenced by the choice of location and growth strategy – "building", "buying" or "borrowing" services.

According to the PwC survey "Alternative asset management 2020: Fast forward to centre stage", the market for alternatives will be spread structurally over three main business models – "diversified alternative firms", "specialty firms" and "multi-strategy firms" – by 2020. As businesses mature, the demand for capabilities will change as their own market position develops. Priorities in management will change in accordance with the life cycle of a business or product. Build, buy and borrow strategies may be applied to grow market share, but also to maintain competitive or exit a market.

Fig. 16 How management priorities change over the life cycle of a business or product



The so-called "builders" are quietly growing through the development of existing skills. Consequently, they are becoming masters of the identification, recruitment and development of talents in order to achieve strategic focus and competence. This group will include above all the large, traditional companies who will continue to develop their platform for alternatives independently.

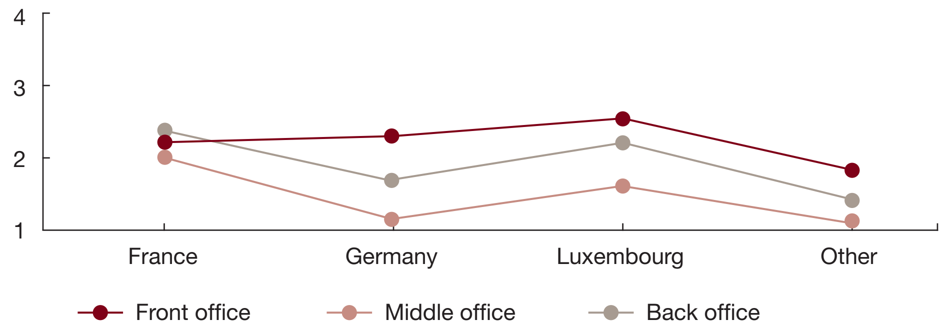
In contrast to this, the "buyers" are looking to increase their skills across all asset classes and strategies overnight through the acquisition of talents and track records. As discussed in PwC's Asset Management M&A Trend Paper, the alternative asset market will dominate the M&A market in future. In this case, the target group will be large alternative companies who are looking to round off their range of services.

The third group, the "borrowers", will aim to grow through partnership-based strategies with other institutions, asset managers, wealth managers, private banks and funds-of-funds in order to further expand their skills and distribution channels. In this case, we will see various forms such as joint ventures and sub-advisory relationships.

Build, buy and borrow strategies can be implemented in different ways. Depending on the stage a business model is at in a life cycle, a new branch in Singapore, for example, would call for an aggressive buy-and-build strategy to increase the market share, i.e., it would invest. The necessary funds for this have to be generated at the same time through cash-cow products in Europe (focus on margin), whilst expiring business models there also require flexibilisation, e.g., through outsourcing.

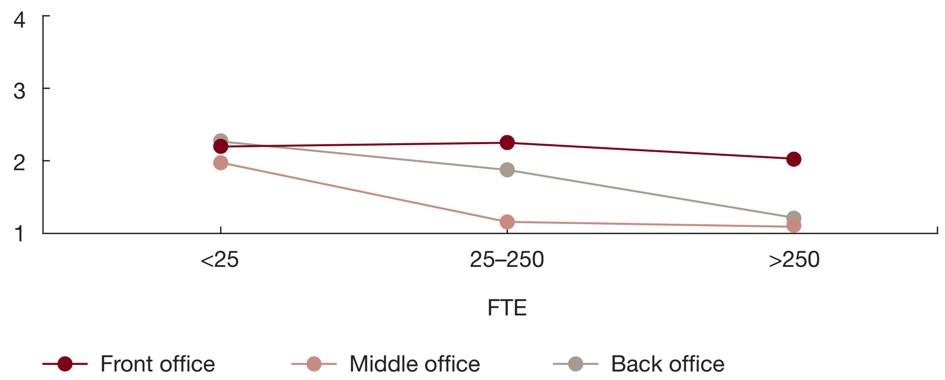
We will be looking at the level of outsourcing in each of the operations-section of this report separately for front, middle and back office operations. As an introduction, the two graphs below are illustrating the different intensities of outsourcing across the three areas of the operating model.

Fig. 17 The intensity of outsourcing in front, middle and back office by country



The graph shows that the level of back office (and middle office) outsourcing varies more between the individual markets than that of the front office. The graph shows a simple average score based on the replies on depth of performance in all three areas. The spread ranges from 1.0 (no outsourcing) to 4.0 (full outsourcing to third-party providers). We can see that France and Luxembourg use outsourcing in the back office (score > 2.0) to a greater extent.

Fig. 18 The intensity of outsourcing in front, middle and back office by size of the managers



In addition, we can clearly see that large managers rely on internal activity in both the middle office and the back office more often than small and medium-sized asset managers. The reason for this probably lies in the scale effects of own performances or with IT investments.

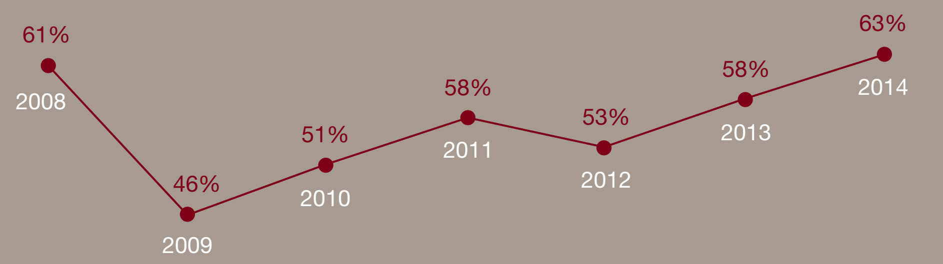
4 War for talents

"The effectiveness with which your organisation manages people for the long term will be critical to its long-term viability, ensuring you have the right people, with the right skills, in the right places to realise your evolving goals. Think too much in the short term and you may find yourself on the back foot, unable to catch up with sudden shifts in your marketplace." PwC survey "The future of work"[3]

The world is changing and so, too, is our business map, driven not only by the aforementioned trends but also by other factors, from technological developments and demographic changes right through to urbanisation. Companies will increasingly have to address the topics of employee strategies in view of the digital era, future changes in the workplace and the recruitment of talents.

Fig. 19 CEOs are becoming more worried about finding key skills

Q: How conncerned are you about the following potential economics and policy/business threats to your organisation's growth prospects? (Availability of key skills was one of the threats CEOs named)



Base: All respondents (2014=1.344; 2013=1.330; 2012=1.258; 2011=1.201; 2010=1.198; 2009=1.124; 2008=1.150)

Source: PwC 17th Annual Global CEO Survey

Fig. 20 New talent battlegrounds

Megatrends are redrawing the skills map for global businesses; the supply of talent is shifting at a time when demand is increasing. This is exacerbating a familiar worry for CEOs; 63% said availability of skills was a serious concern, an increase of 5% on 2013. With half of CEOs planning to hire more people over the next 12 months, competition for talent will be intense. Wage arbitrage is a growing concern; 58% of CEOs are worried about rising labour costs in high-growth markets.

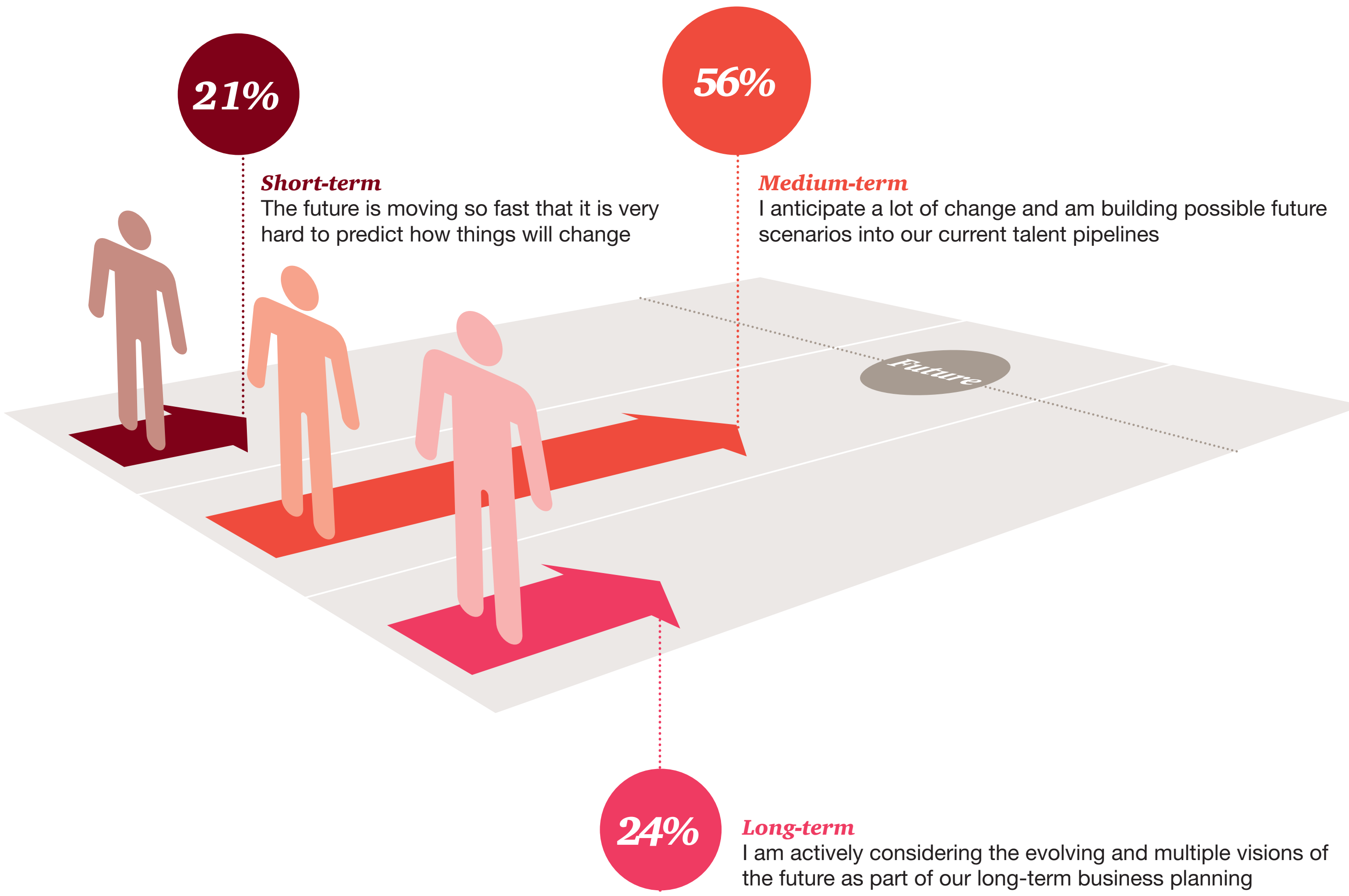
[3] http://www.pwc.com/gx/en/issues/talent/future-of-work/journey-to-2022.html

Two-thirds of the CEOs worldwide who were polled by PwC in the course of the *17th Global CEO Survey*[4] reported that one of the greatest challenges they face is finding employees with the necessary skills. Half of those CEOs plan to increase the number of their employees in the coming 12 months. The logical consequence of this is that competition for talented employees will grow – and in future, CEOs will have to change their talent management strategies in order to meet this challenge.

The CEO survey shows that CEOs worldwide perceive the topic of technology as the most important megatrend which will lead to changes in all areas of business. Our comprehension of how and where we will be working in future and how new employees will be recruited, trained and managed harbours new challenges for talent management.

According to the PwC survey "The future of work", companies – and in particular personnel departments – are already responding to a variety of future scenarios in their personnel and business planning, though only a few follow the long-term approach. A majority of those polled in the survey stated that they were not prepared for the future changes among market participants (flexibility, autonomy and freedom). Likewise, the survey clearly indicates that 80% of the participants have so far not taken into consideration the future role of technology and automation, although they consider them to be important.

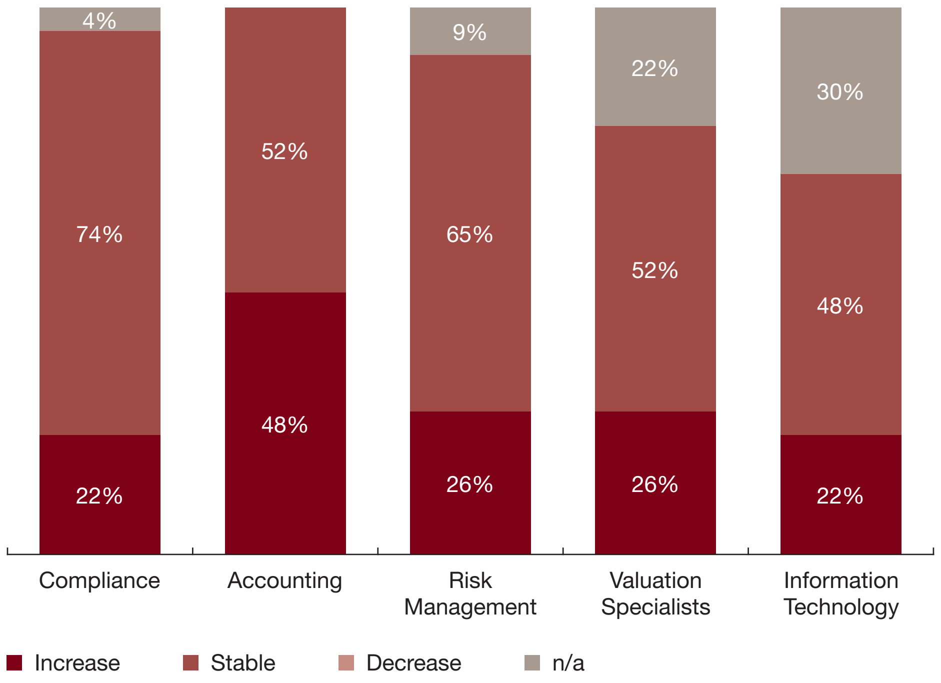
Fig. 21 Availability of skills – CEOs are becoming more worried about finding key skills



[4] http://www.pwc.com/gx/en/ceo-survey

This is why for the first time our survey includes questions on HR supply and demand for selected functions. With compliance, risk management and valuation, these include functions facing increased legislative requirements. Accounting and information technology are also areas of responsibility that are affected by the tightened regulations. At the same time, they are also sensitive to growth and digital transformation.

Fig. 22 How will demand for resources to evolve over the next twelve months?

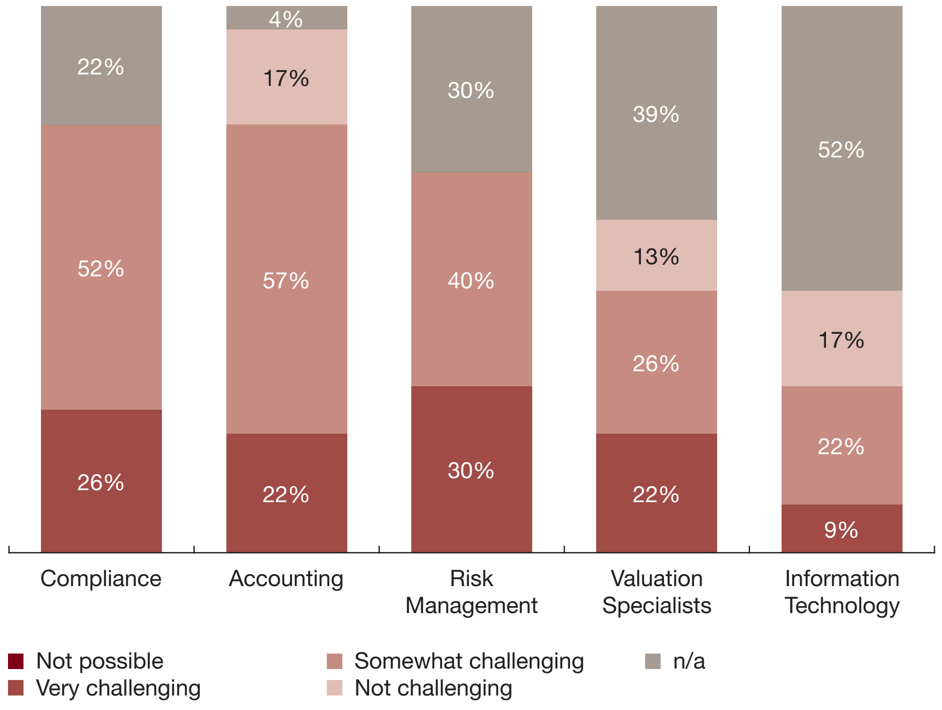


Consequently, all participants expect a constant or growing need for employees for these functions; 48% of the participants see a growing HR demand for accounting, but only 22% for IT.

At the same time, more than two-thirds of the participants regard meeting their human resources requirements in the functions of compliance, accounting and risk management as a challenge. The situation appears to be more relaxed in the case of valuation and IT experts.

As a consequence, the accounting function in particular is in danger of becoming a limiting factor for growth. Possible solutions may be found in increasing efficiency, through scaling effects by pooling in shared service centres, outsourcing or growing fund sizes, and in the automation of processes.

Fig. 23 How challenging is it to find the right resources?



5 Sustainability – Not a commodity yet

Sustainability will increasingly become “a new normal” for most businesses, and at the same time it will represent an important value-adding factor alongside technology in the sector of asset management. Driven by the construction activity and increasing commercialisation of technology and digitalisation in the real estate market, there will also be an acceleration of “green” building. Real estate users will increasingly demand the use of solar panels and efficient heating systems and also be prepared to pay for them accordingly. In future, buildings will be designed so that offices have natural sunlight and good air quality. Buildings with low sustainability factors will lose their attractiveness, in addition to having poorer performance and shorter life cycles.

Sustainability, in particular sustainable investment, is an approach aimed at the long-term factors relevant for the investor, namely environment, social affairs and governance. First and foremost comes the achievement of a long-term sustainable return through a stable, well-functioning and socially, ecologically and economically operated company.

The United Nations-supported Principles for Responsible Investment (PRI) is an investor initiative in partnership with the UN Environment Programme (UNEP) Finance Initiative and the UN Global Compact. The Principles reflect the increasing significance of the areas of environment, social affairs and governance – or ESG for short – for investment decisions. An international group of institutional investors developed the following six principles.

Trends on radar

Fig. 24 Principles for Responsible Investment

1. ***We will incorporate ESG issues into investment analysis and decision-making processes.***
2. ***We will be active owners and incorporate ESG issues into our ownership policies and practices.***
3. ***We will seek appropriate disclosure on ESG issues by the entities in which we invest.***
4. ***We will promote acceptance and implementation of the Principles within the investment industry.***
5. ***We will work together to enhance our effectiveness in implementing the Principles.***
6. ***We will each report on our activities and progress towards implementing the Principles.***

Source: http://www.unpri.org/about-pri/the-six-principles

Since its inception, more than 1,200 signatories from all continents with total assets of $34 trillion (as of January 2014) have signed the PRI. That represents 15% of globally invested capital.

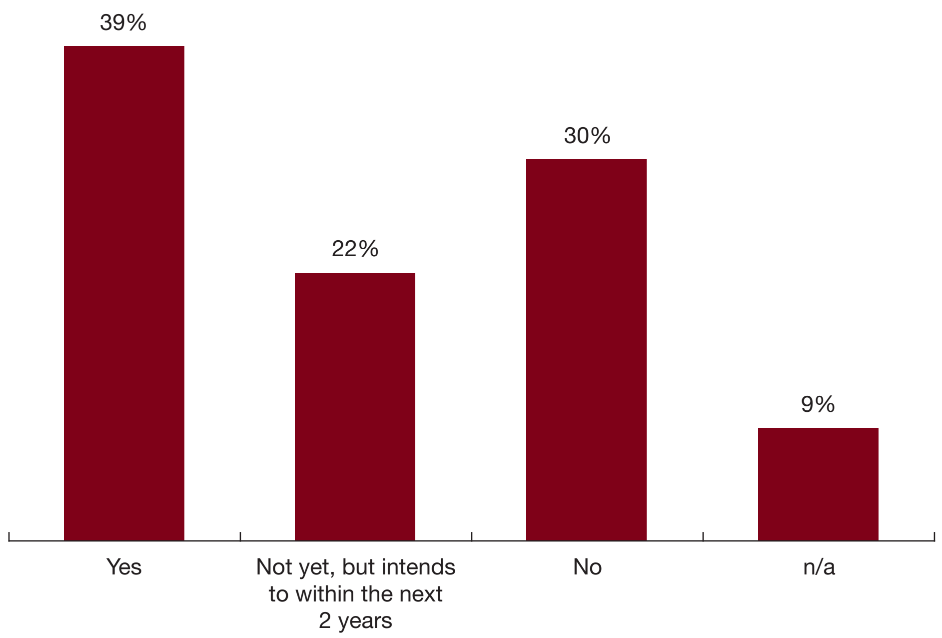
Signatories pledge to research, analyse and evaluate the ESG criteria and to use this information to assess the value and performance of investment projects. This approach is experiencing growing acceptance in the financial sector, driven no doubt by both increasing regulatory requirements and growing demand from investors.

In the opinion of numerous market participants, the Principles are one of the leading road maps for sustainability for asset managers. They go far beyond the purchase of “green” buildings with regard to claim and scope. Nevertheless, it is at the discretion of every asset manager to decide how and at what speed they are to achieve “sustainability”.

Although the pressure to achieve greater sustainability is undeniable, the topic of sustainability appears to be losing some of its shine, or at least losing prominence in reporting. Until very recently, sustainability was an important innovation area, however now, it is increasingly being treated as a must-have, and is addressed as a matter of course and without any of the excitement that once surrounded it. This is probably not a good idea, particularly in current era of social instability and digital revolution, when ecological and socially acceptable investments coupled with good governance could represent a particularly high added value. For this reason, we also examined the sector’s position with regard to sustainability in the course of this survey.

The results are an impressive testament to the importance of the PRI. To date 39% of the participants have already become signatories, and a further 22% plan to do so in the next two years. The front runners in this respect are the larger asset managers, so that 70% of the AuM might soon be managed according to the Principles.

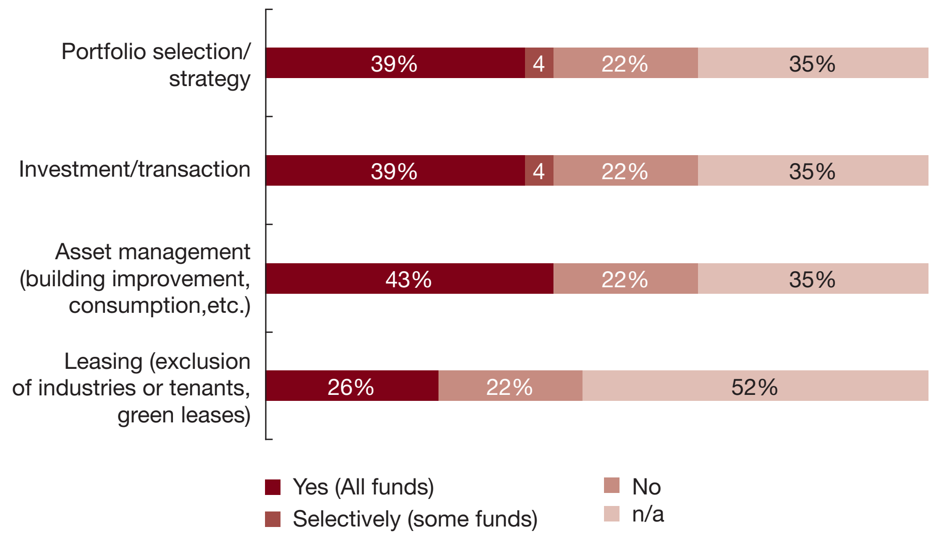
Fig. 25 Has the manager/advisor subscribed to the Principles for Responsible Investment?



We also asked the participants if they had implemented PRI policies in their decisive value-adding processes. This is the case for only about 40% of the participants with regard to portfolio selection, investment and asset management. Only about one-quarter of the asset managers take PRI policies into account in leasing processes.

These numbers demonstrate that there is still an urgent need for further improvement in the industry. Consequently, sustainability remains a long way off from being a commodity.

Fig. 26 Have PRI policies been implemented?



D Business model

In the following section, we will discover how homogeneous or heterogeneous the group of participants is by comparing business models in terms of products, clients and price models.

1 Products

As expected, real estate investment solutions, at 83%, are the leading product category of the participating real estate asset managers. Of the funds and mandates, around two-thirds relate to core products and a further 12% to value-added, opportunistic and mixed real estate strategies.

Fig. 27 What are the risk profiles of the funds or mandates?

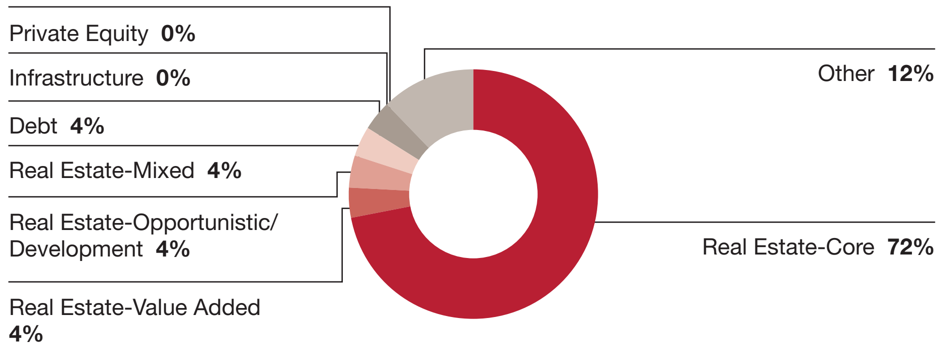
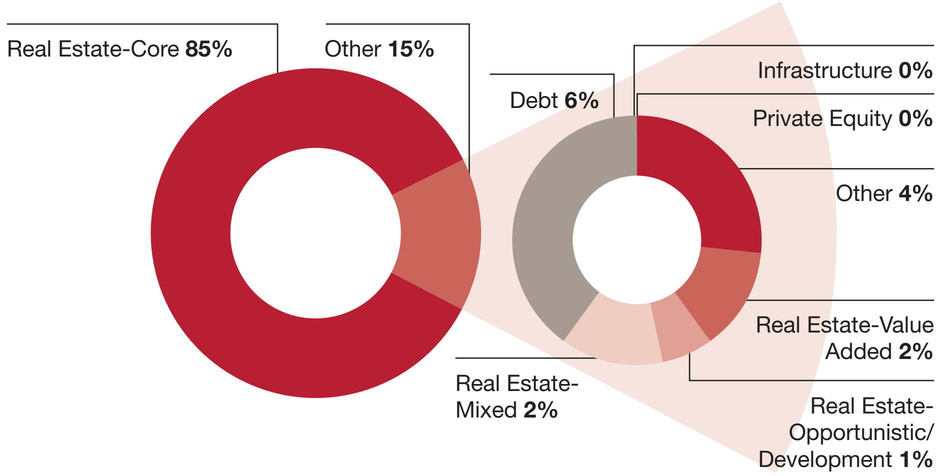


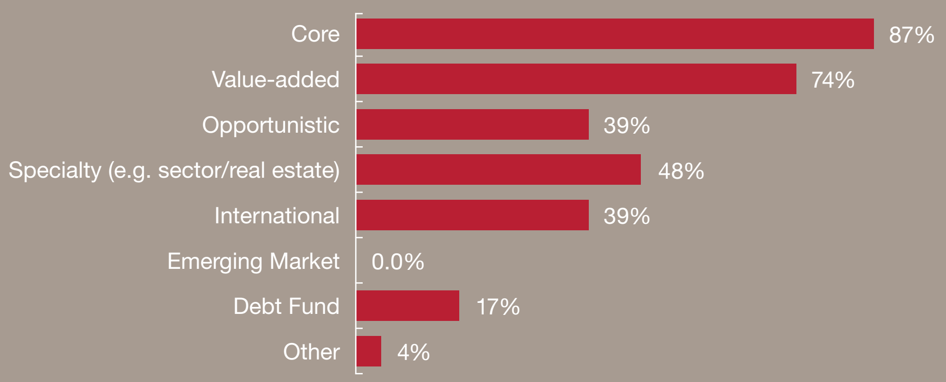
Fig. 28 By AuM, core strategies clearly dominate the industry



The dominance of pure core products is even greater in the analysis of AuM. In this case, 85% relates to the core sector. The findings give relevance to concerns about falling returns, rising investment pressure and the fear of a real estate bubble. In an industry heavily exposed to core real estate, is it too late to switch to the allegedly more profitable value-added and opportunistic segment? Or rather, how long can asset managers wait in their safe core haven to see if the bubble finally bursts?

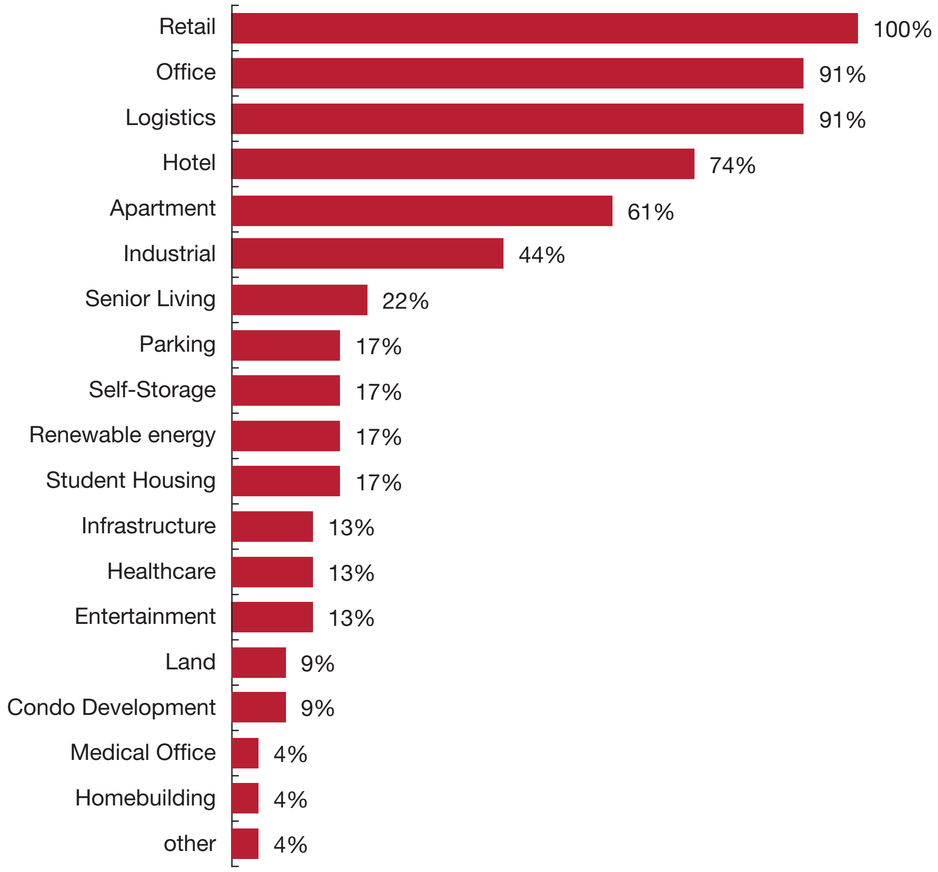
The following graph, however, shows that the majority of asset managers are already relying on a variety of investment styles.

Fig. 29 What investment strategies are applied by the managers?



According to this graph, nearly all participants are using core and value-added strategies. Around half of them also offer special niche strategies, such as single type of use or country funds and international diversified and opportunistic investments.

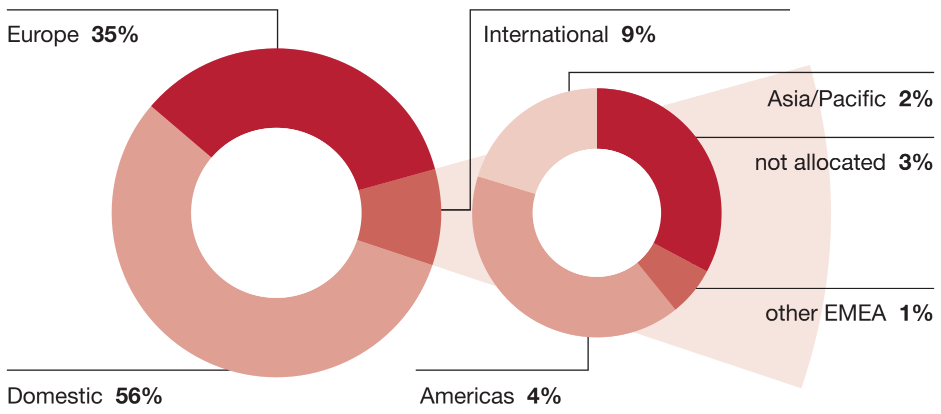
Fig. 30 What asset classes are targeted by the managers?



The particularly liquid submarkets of retail, office and logistics are represented under the asset categories of nearly all providers. A surprisingly large number also offer their clients hotel (74%), apartment (61%) and industrial (43%) investments. Overall, residential uses are underrepresented. The results of this graph differ significantly from the sentiment of the last "Emerging Trends in Real Estate, Europe 2016" report[5], which judged many residential uses to have good short-term performance prospects.

[5] http://www.pwc.com/gx/en/industries/financial-services/asset-management/emerging-trends-real-estate/europe-2016.html

Fig. 31 What is the regional split of the real estate portfolio under management?



With regard to the location of the investments, there is evidence of a significant home bias on the part of the industry. Based loosely on the motto "all business is local", 56% of investments are located in the respective home markets of the participants. A further 35% are located in neighbouring European countries. Less than 10% of the AuM are invested outside Europe. This graph no doubt reflects the historical competence and clients of the asset managers. However, it does not reflect a selection of the most attractive real estate markets. The Americas, with the largest real estate market worldwide, the US, as well as the region of Asia/Pacific, do not yet play any significant role. With regard to worldwide diversification of the portfolio and participation in global growth stories, this puts European markets in anything but pole position.

Fig. 32 What product types are managed by the participants?

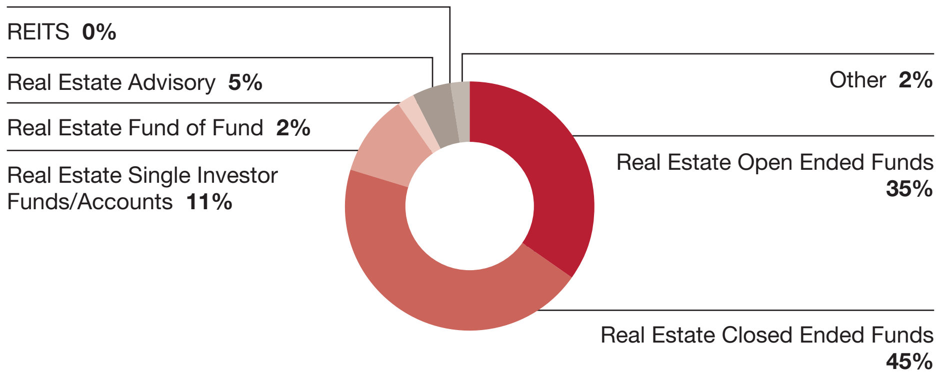
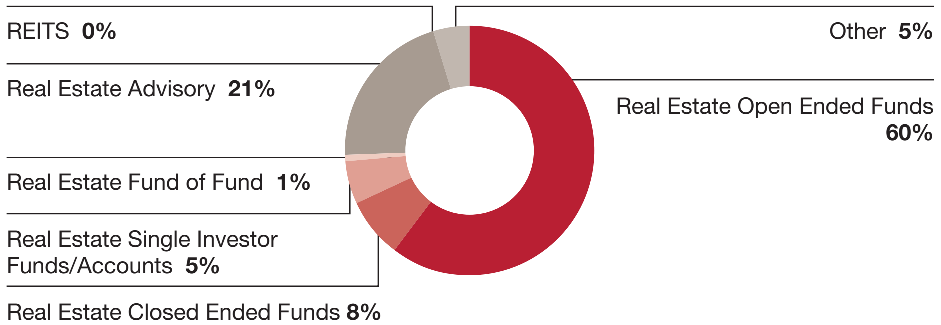


Fig. 33 Open ended funds have the highest share in AuM in this survey

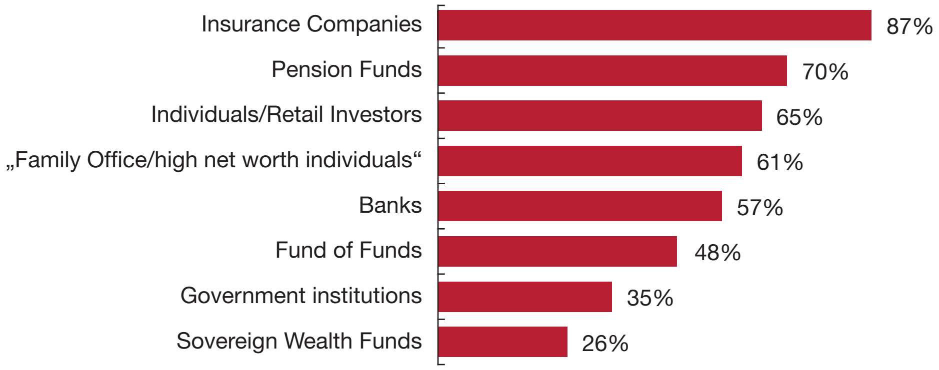


At 45%, closed-ended funds take first place among the preferred types of funds or mandates this year, followed by open-ended funds at 35%. The picture takes on a new tint when the fund volumes are compared: open-ended funds now dominate at 60%, followed by advisory mandates at 21% of AuM.

2 Clients

As in the previous year, insurance companies, pension funds and retail clients represent the three large investor groups among our participants.

Fig. 34 What groups of investors have signed the funds?



By far the largest amount of funds (74%) originates from the managers' home countries. A further 12% comes from European capital markets. In comparison, American and Asian investors are hardly represented. The picture does not vary much in the individual countries of origin; only managers in Luxembourg have their investor focal point outside of the domestic market in Europe (95% of AuM).

Fig. 35 What is the geographical origination of the equity invested?

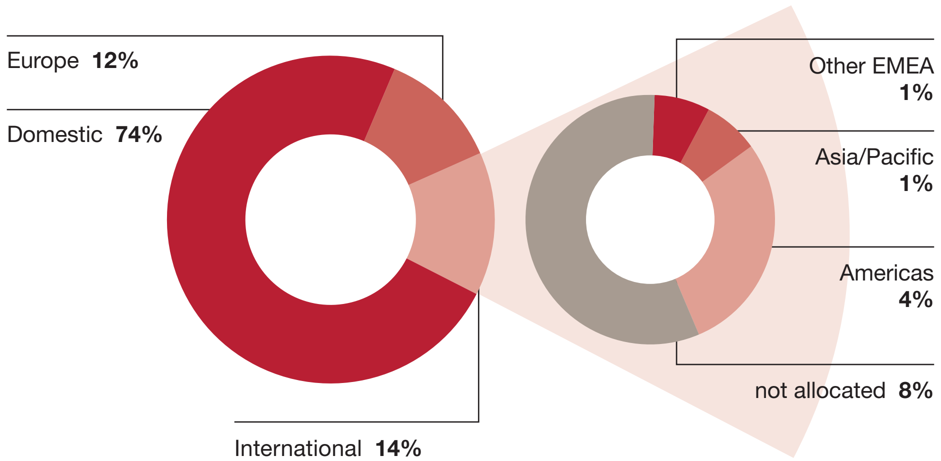
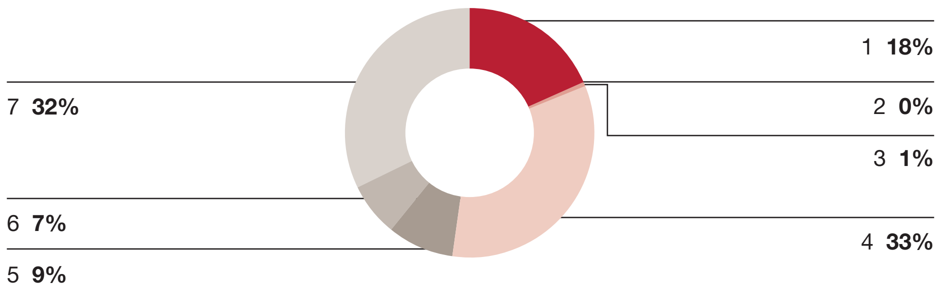
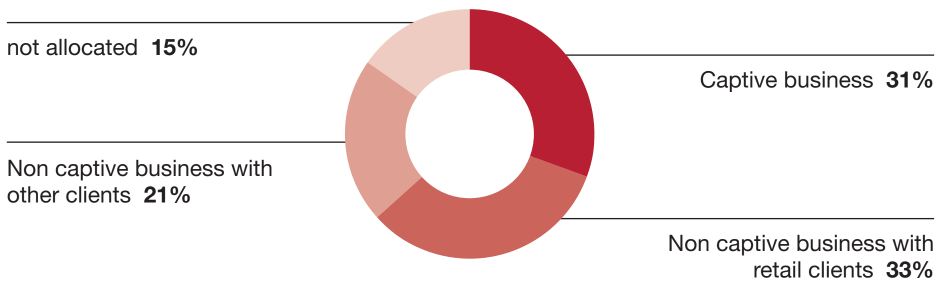


Fig. 36 How many investor groups does a manager service, scaled by AuM?



It is striking that a focus on a single client group can only be observed in the case of a few managers. Only about 20% of AuM relate to specialised managers. In comparison, 80% of AuM are administered by managers who address four or more client groups with their products.

Fig. 37 What is the origination of business?



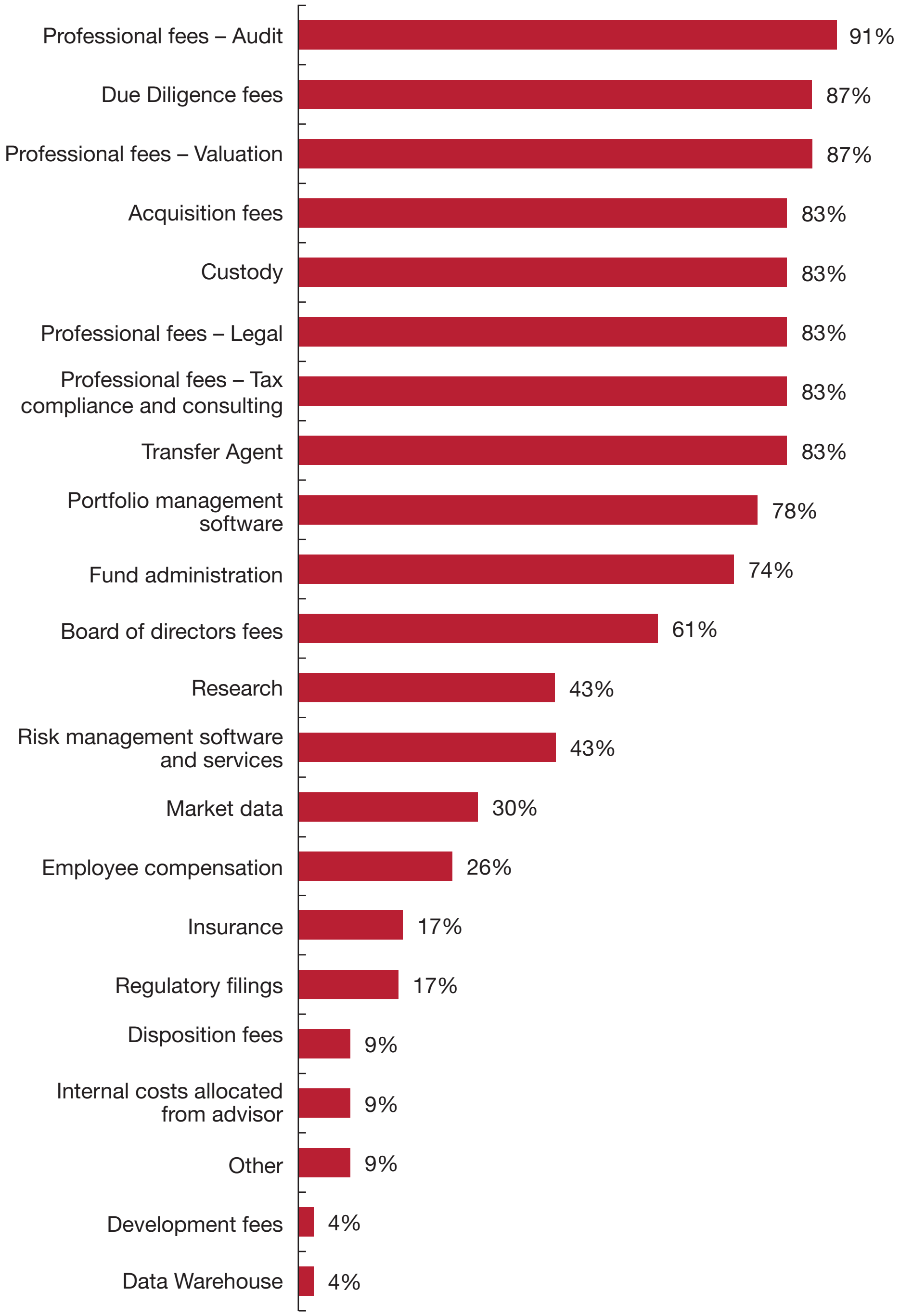
Some 31% of AuM are captive, i.e., not raised on the capital market, and originate mostly from insurance companies of the same group. Retail clients, at 33%, represent the largest share of the funds, followed by the remaining non-captive clients.

3 Price

When it comes to the costs that investors are charged in addition to manager's fees, the picture that arises is highly differentiated, yet at the same time quite consistent. Topping the list is the group of middle and back office costs (e.g., audit, tax compliance, fund administration, custody and valuation), as well as transaction-related costs for services such as acquisition and disposal fees of agents, due diligence and legal costs. The costs of IT systems, research and/or market data are seldom charged.

As a result, we find that the recovery of costs has a distinctively uniform pattern. Significant differences are not evident in a country-by-country comparison and anomalies only exist in individual cases. It would therefore be possible to postulate that the creation of a harmonised European market intended by the creation of the AIFMD has at least become reality with regard to remuneration.

Fig. 38 What costs are generally borne by the funds?

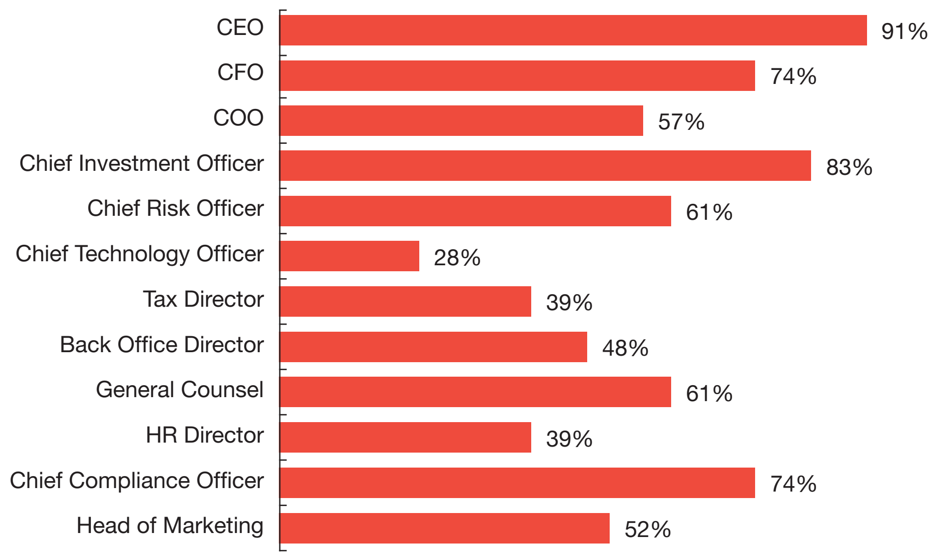


E Operations

Starting with important elements of corporate governance, front and middle office, this section contains a deep dive on back office operations.

1 Governance

Fig. 39 Does the manager/advisor have the following dedicated functions?



The most common functions of the C-suite are the chief executive officer (91%), chief investment officer (83%) and chief finance and compliance officer (74% each), followed by the chief risk officer and chief operating officer. In comparison, the chief technology officers only represent a fringe group at 22%. In the second row, only the general counsel, head of marketing and back office directors are represented with a majority of participants.

Fig. 40 What is the organizational set-up of the manager/advisor?

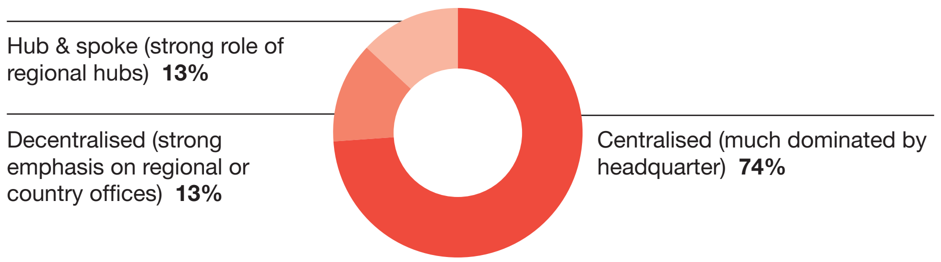
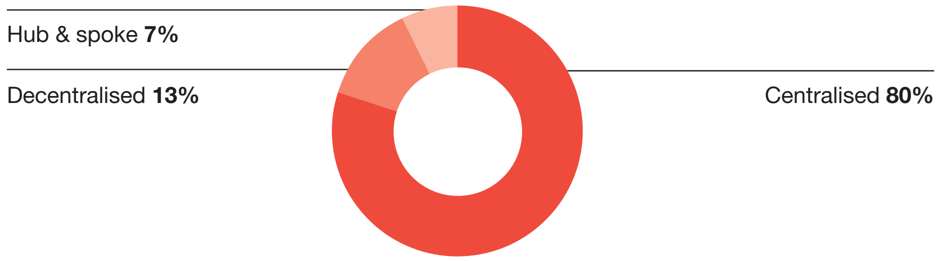


Fig. 41 Organizational set-up as surveyed in 2014



Nearly three-quarters of the participants describe their operating model as centralised, i.e., the main decisions and capacities of the company are concentrated at the headquarters. The remaining quarter is divided into approximately even parts in the decentralised governance model (i.e., decisions in the local branch offices) and the hub-and-spoke model, where regional responsibility dominates.

Committees play a decisive role in the governance structure for many managers. The graph shows that investment committees are the European standard for reaching investment decisions (91% of participants). Also, 70% of the participants have a risk management committee, which mirrors the upgrading of this function by the AIFMD, as well as a new product committee. More than half have a valuation committee or a regulatory and compliance committee.

Fig. 42 Does the advisor have the following committees?

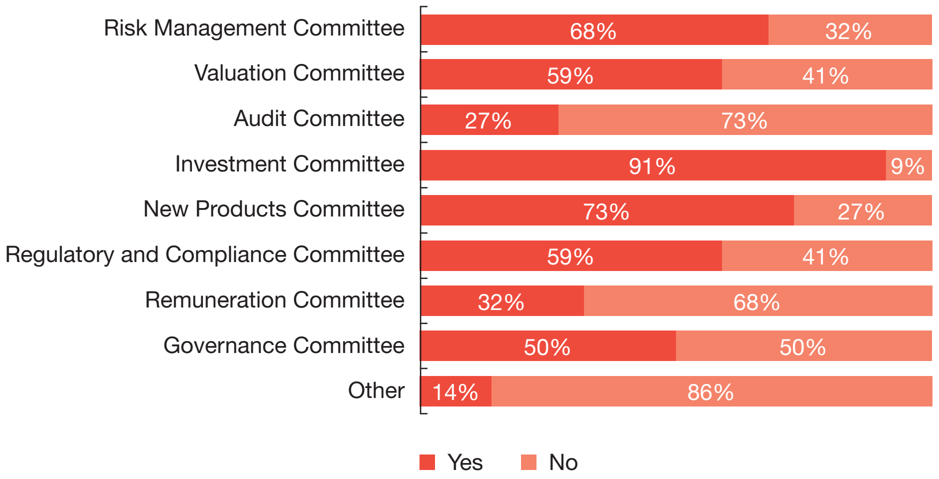
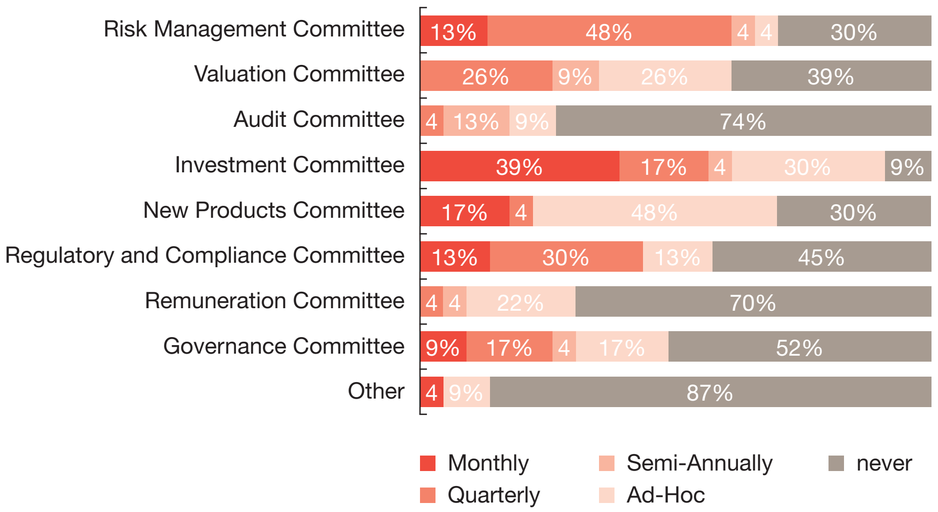


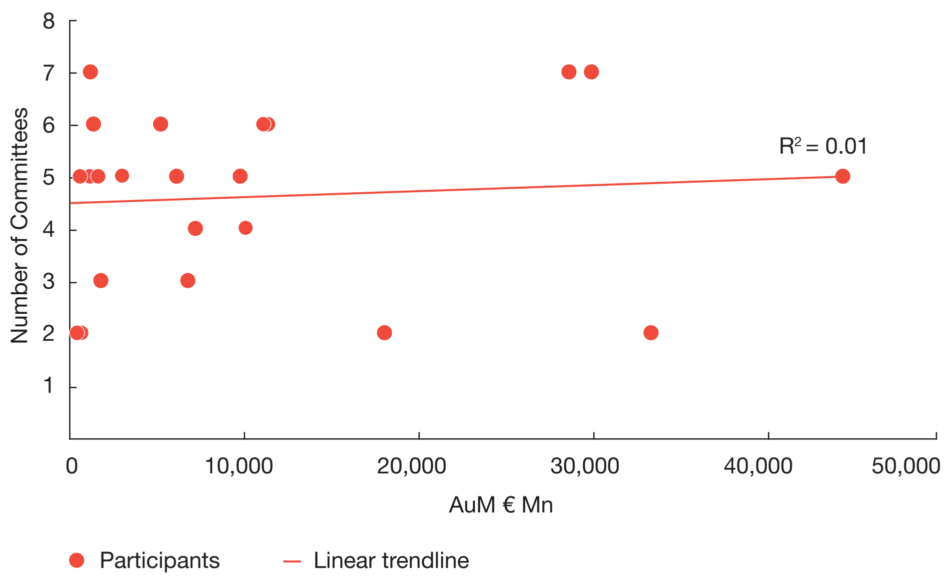
Fig. 43 How often do committees meet?



According to the survey, investment committee meetings are the most frequent, the audit committee the least frequent and the new product committee the most sporadic.

What are the main factors for installing a committee or deciding against one? The size of the organisation measured by FTE has only a slightly positive correlation with the number of committees, with a correlation coefficient of 0.19. If the number of committees is compared with the AuM as benchmark, which compensates for outsourcing effects, there is also no evidence of any dependency (correlation coefficient = 0). Nor does an analysis of the participants' home countries bring any striking pattern to light.

Fig. 44 What is the relation between number of committes and size of portfolio?

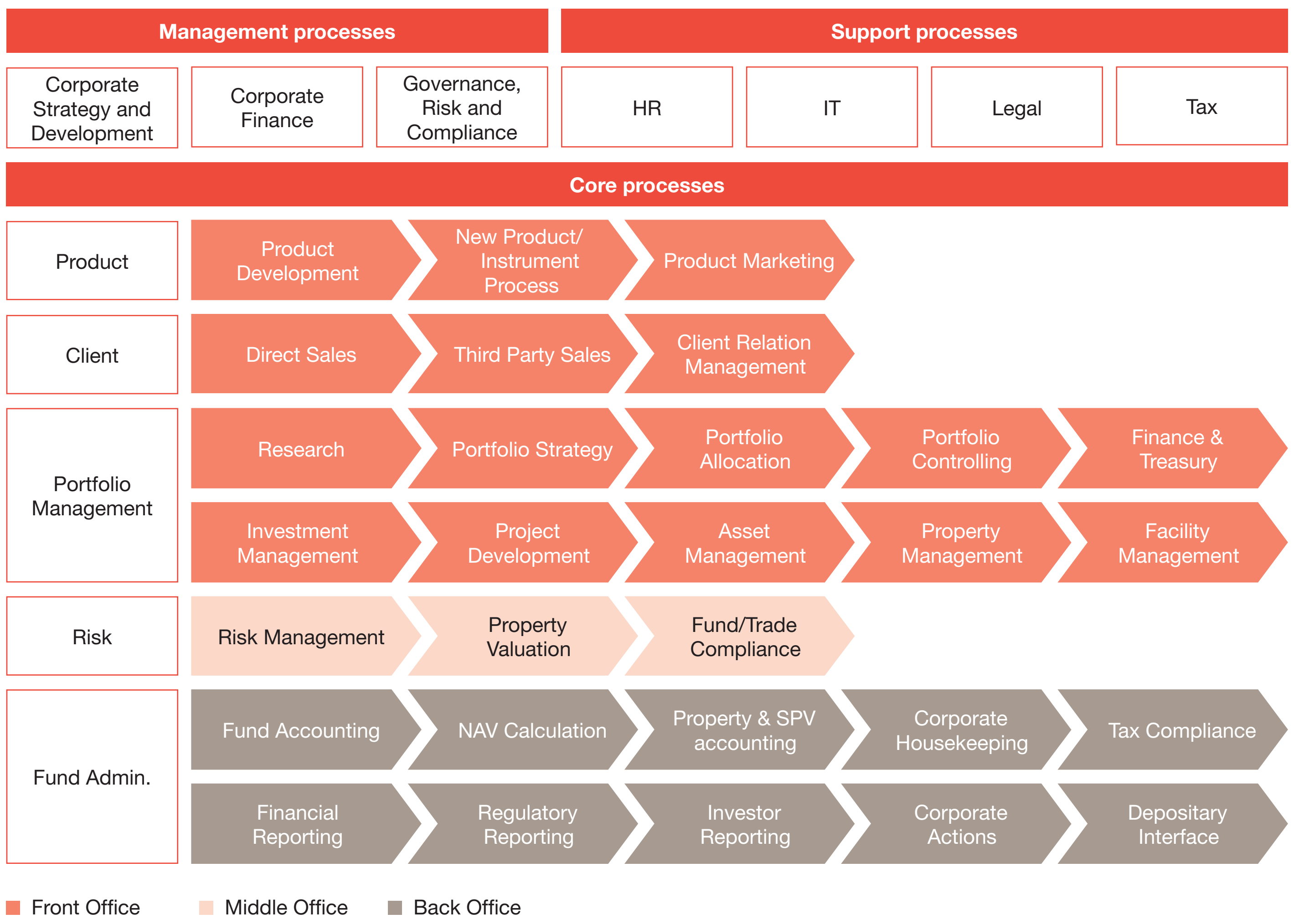


Investment, risk management and new product committees form a standard of the industry. Apart from that, committees remain a phenomenon requiring further explanation.

2 Front office

Below, we describe the findings relating to the front, middle and back offices of real estate asset managers. We understand front office to represent the market-side, value-adding processes such as product development, sales and client relations, as well as portfolio management. In doing so, this year we have focused our survey on outsourcing in portfolio management and the activities of the investment committee.

Fig. 45 The PwC model of processes for Real Estate Asset Managers



2.1 Make or buy in portfolio management

As opposed to outsourcing, it is the internal activity that sets the industrial standard in fund, investment and asset management. Complete outsourcing of these functions was not observed in the case of any of the participants. The picture is mixed in the case of leasing and development: with a high level of internal contributions on average, external partners are also used for part-services.

The industry is also in agreement that facility management and – to a lesser extent – property management should not primarily be regarded as part of the core business of the REAM and therefore are to be outsourced.

Fig. 46 Have the following real estate management functions been outsourced?

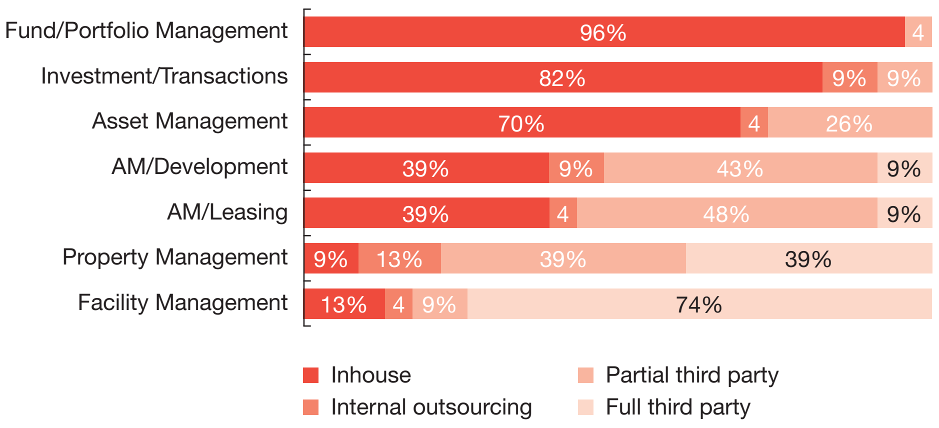
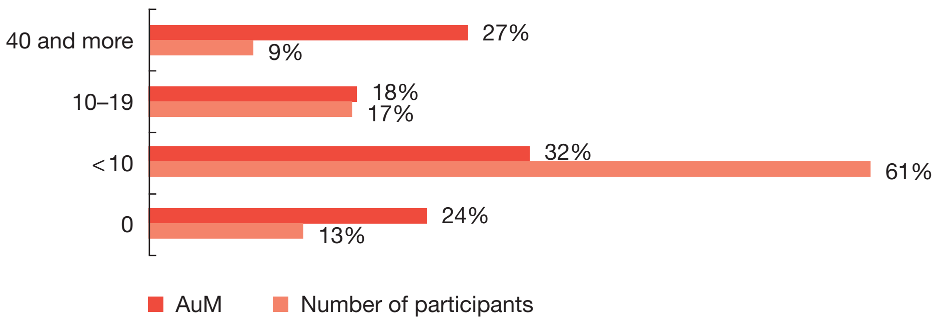
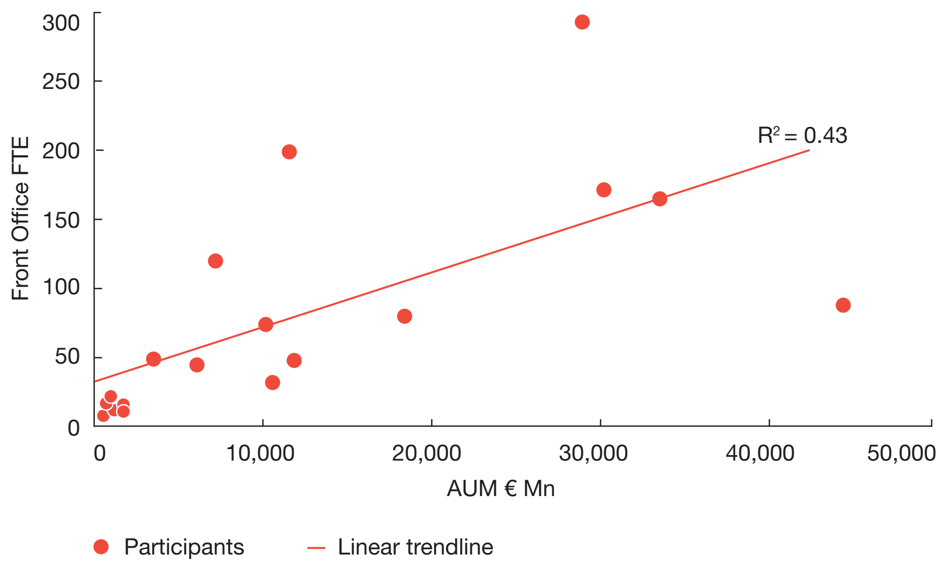


Fig. 47 How many external property management agents are under contract?



In this respect, the majority of asset managers have fewer than ten property managers under contract. In particular, we can see large differences in the case of large-scale managers where the range stretches from more than 40 to fewer than 10; in one case, property management is even provided by a captive supplier.

Fig. 48 What is the relation between FTE in the front office and AuM?

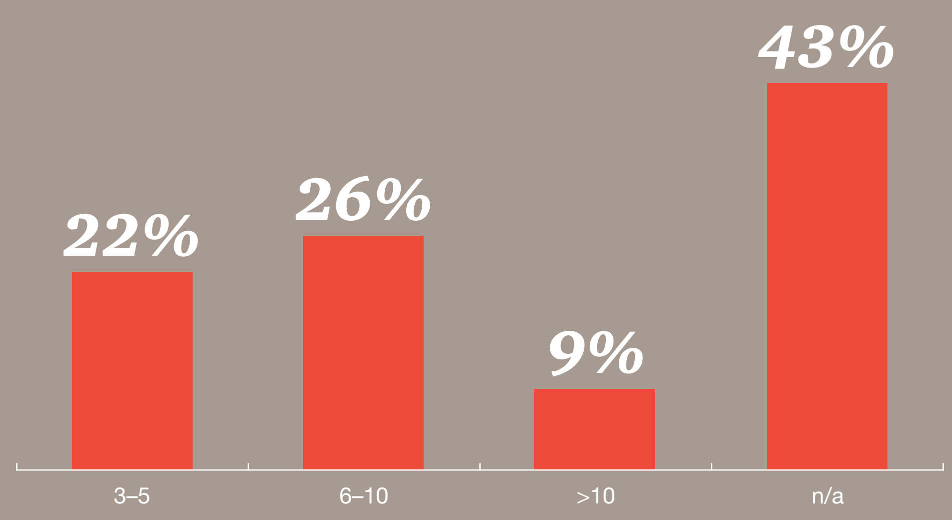


The wide spread in service relations in front office FTE and AuM can be explained using the outsourcing analysis. Both have a strong positive correlation with a correlation coefficient of 0.66. A trend line, however, can only be drawn with a coefficient of determination of 0.43.

2.2 Investment committee

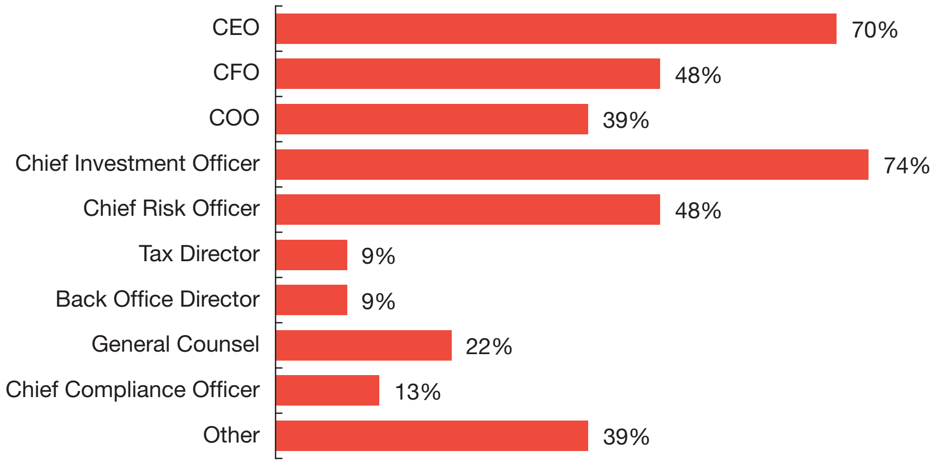
With the formation of an investment committee, asset managers are reacting to the high frequency of investment decision-making or at least to the submission of tenders that call for a frequent meeting board of experts. Consequently, in many cases the Investment Committee is a management board with direct resolution-adopting powers which is supplemented with experts from research, risk and fund management, investment and asset management.

Fig. 49 How many members has the Investment Committee?



The majority of investment committees consist of between six and ten members. The most prominent members are naturally the chief investment officer followed by the CEO, CFO and chief risk officer, followed by the COO and "others" – presumably experienced industrial and management experts of the front office.

Fig. 50 What functions are represented in the Investment committee?



3 Middle office

3.1 Risk management

In comparison to the front or back office, where we have observed a wide range of different levels of outsourcing, a more harmonious image can be seen in the case of the middle office and, in particular, risk management. Outsourcing plays a subordinate role in nearly all areas. This is more likely to be due to the high complexity of the interface to a potential third-party provider in combination with hardly achievable cost advantages than to the high regulatory hurdles for outsourcing these core functions of an AIFM.

Fig. 51 Have the following middle office functions been outsourced?

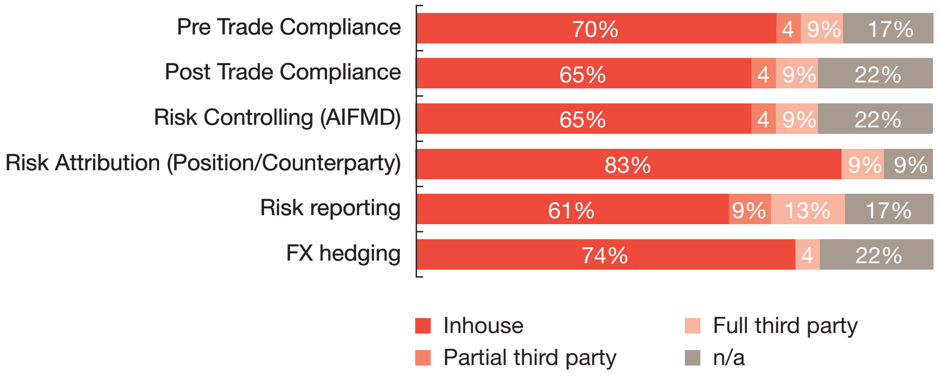
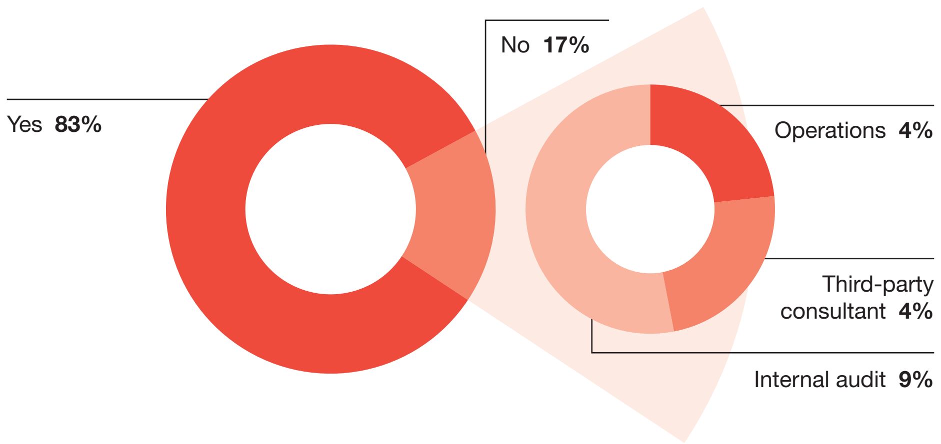
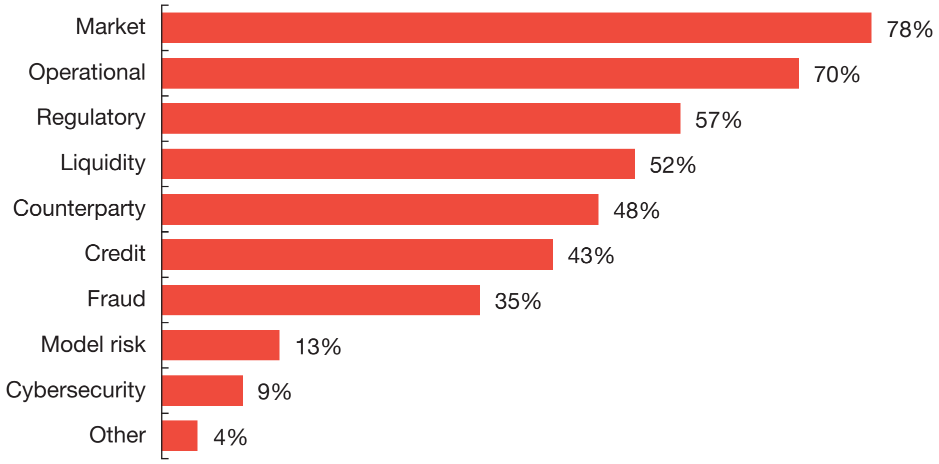


Fig. 52 Does the advisor have a dedicated risk management function? If no, where do the risk management responsibilities reside?



The rise in the importance of risk management can also be seen in the organisational implementation: 83% of the participants have a dedicated risk management function (78% in the previous year).

Fig. 53 What are the advisor's risk management priorities?



In order to gain an overview of the current mood, we asked about the priorities of risk management. The graph shows the frequency with which individual types of risk were named. Market risk is top-ranked not only on average but also with the highest number of votes as being top priority. Operational, regulatory and liquidity have high priority for the majority of participants.

3.2 Valuation

The valuation committee is an important aspect of the control environment in the US and is intended to ensure the independence of the valuation function. European governance initially takes a different route. The AIFMD and its local implementation are mostly aimed at achieving a functional separation of the valuation function from front office responsibilities. National regulation partly demands external experts and an obligatory rotation.

Valuation committees, however, are compatible with the national AIFMD acts of numerous member states and are used by 60% of the participants of our survey. In contrast to the US, however, their area of responsibility is restricted to reviewing third-party valuation reports and monitoring valuation models and methods.

Fig. 54 What analysis is provided to/reviewed by the valuation committee?

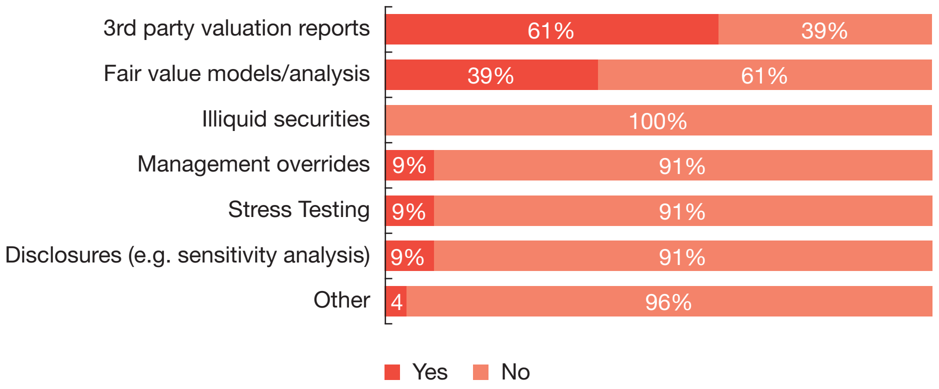


Fig. 55 Does the valuation committee review and approve the valuation policies? If so, how often?

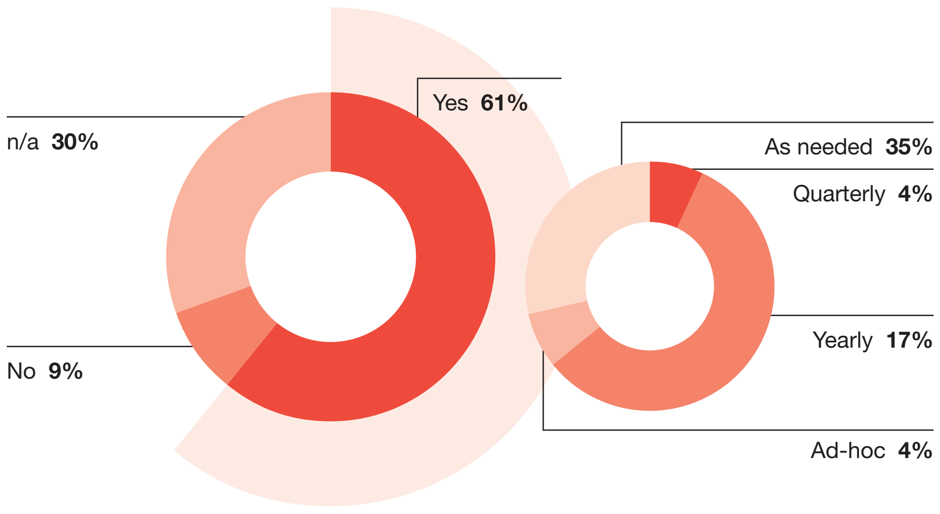
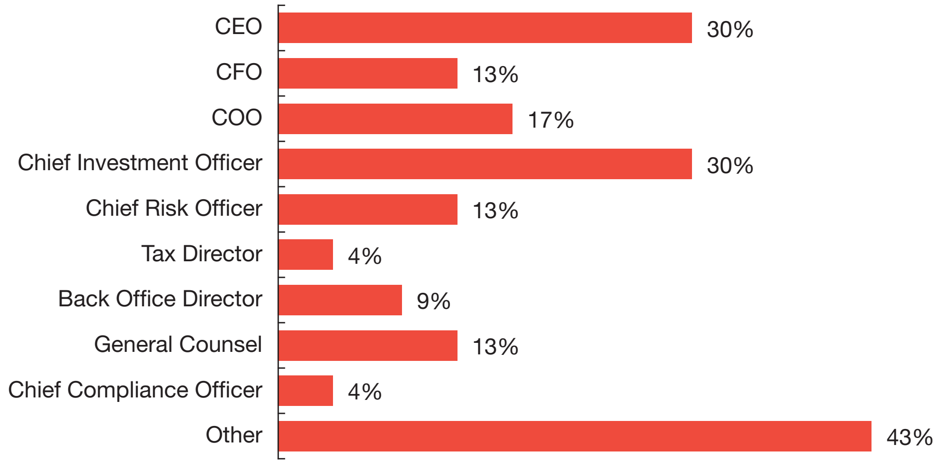
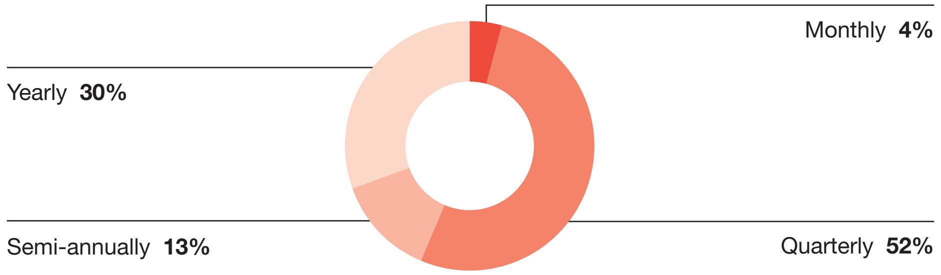


Fig. 56 Who are the members of the Valuation Committee?



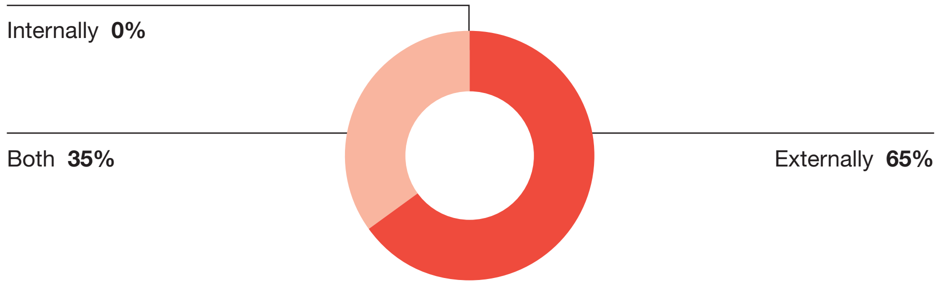
The composition of some European valuation committees is striking. As the graph shows, the Chief Investment Officer is represented in 30% of the valuation committees, despite being likely to have conflicts of interest. The same risk applies to many CEOs, who are also present in 30% of the valuation committees. Neither would presumably correspond to the motives of either American or European governance.

Fig. 57 What is the frequency of property valuation by external appraisers?



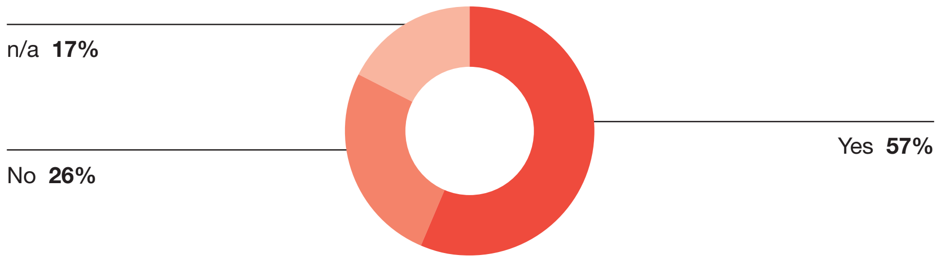
More than half of the participants carry out quarterly valuations of their assets. In line with market customs or local regulation, two-thirds exceed the minimum requirements of an annual valuation according to AIFMD. As a consequence, the image of the valuation culture in the industry has become a positive one.

Fig. 58 Are valuations carried out internally or by third party appraisers?



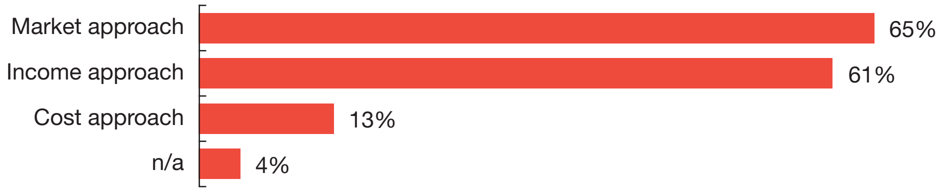
Around two-thirds of the participants have valuations carried out by external appraisers. As in the previous year, one-third also carry out internal valuations. A total of 19 of 23 participants challenge the results of the external valuations. The estimates for vacancies, ERV, surface area, yield, cap rate and fundamental market data are the most frequently named in this respect.

Fig. 59 Do external valuers accept their role under AIFMD?



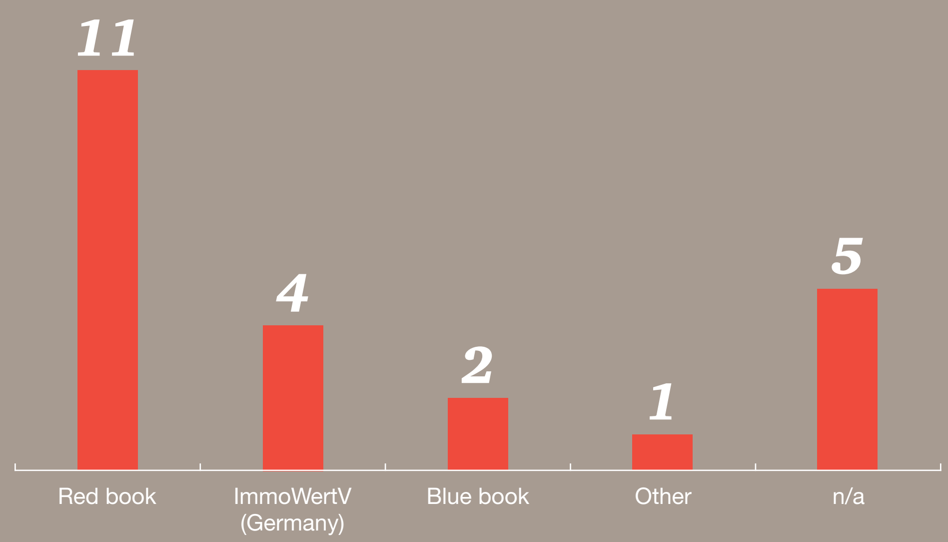
The extended requirements and obligations for the external valuers under the AIFMD have already been accepted by the majority of the valuers; only 26% (2014: 33%) are not yet completely sure about their new role.

Fig. 60 Which valuation methodologies are being used?



As expected, the market approach and/or income approach are used by around two-thirds of the participants. The use of the cost approach is down in comparison to the previous year (from 22% to 13%) – which is also a sign of the maturing valuation culture in Europe.

Fig. 61 Which professional rules/rules of conduct does the valuation function follow?



The Red Book of the Royal Institution of Chartered Surveyors (RICS) has become accepted as the leading valuation standard among approximately half of the participants. ImmoWertV, a German valuation standard, was named in second place. The European value-determining standard, the "Blue Book", is used by two participants.

4 Back office

The back office, with the main functions of fund accounting and administration as well as reporting, is an area of the value chain which foresees a wide variety of operating models that can be derived from national regulatory features and market usage.

Along with securing the regulatory requirements on accounting, reporting, tax compliance and the supply of the information requirements of management and investors, i.e., overall complex requirements, efficiency is expected of the back office in particular. At the same time, the back office is not regarded as a value-adding area of operations. As a consequence, outsourcing is applied to varying extents and in various forms. As such, the organisation of the back office forms the focal point of the analyses of this report.

Fig. 62 How to improve efficiency of back-office and support functions

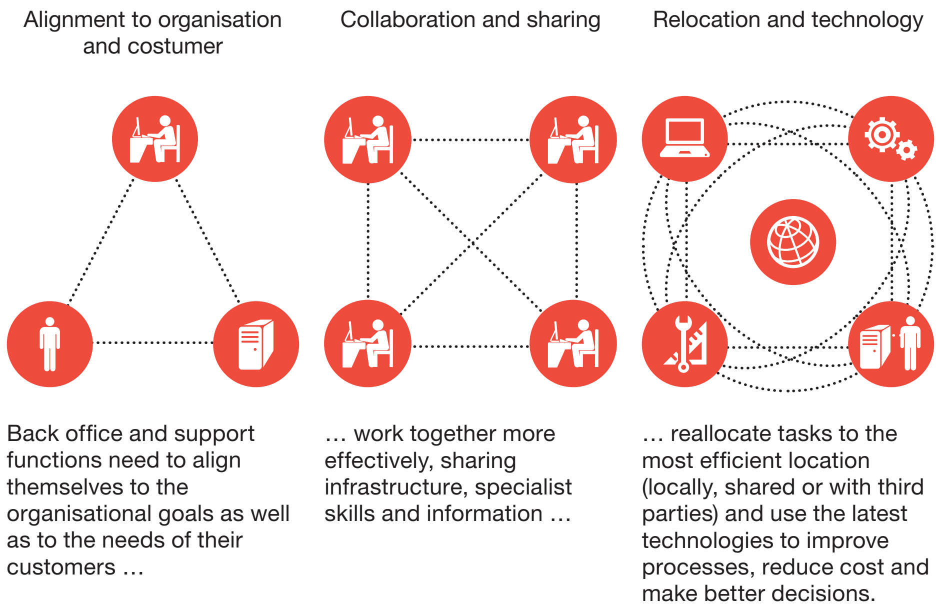
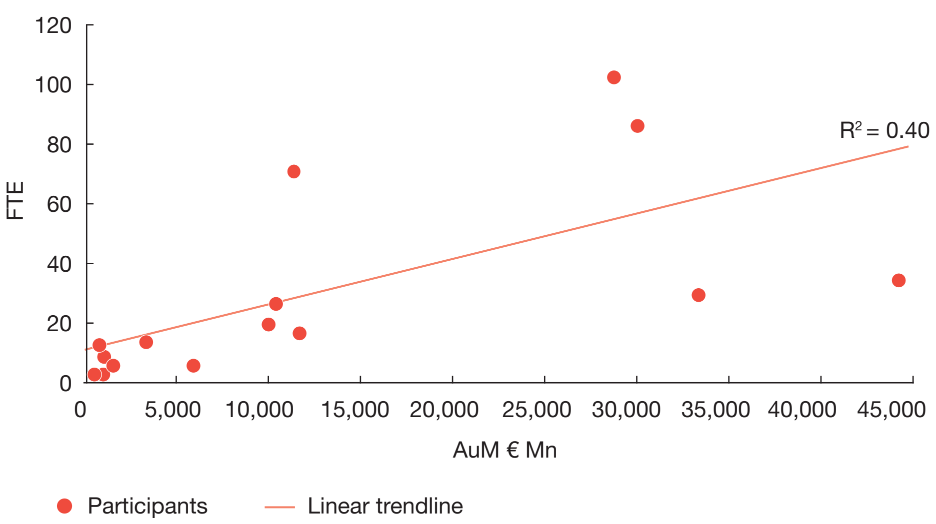


Fig. 63 What is the relation between FTE in the Back Office and AuM?



An evaluation of the back office FTE by AuM shows a relatively high spread due to varying outsourcing intensity, as already mentioned. Nevertheless, with a coefficient of 0.63 the correlation of both factors is clearly positive. The number of funds and/or clients as a second possible cost driver, however, has only a very weak correlation with the number of employees in the back office, at 0.12.

In terms of outsourcing, 74% of the participants do use external fund administrators at least for part-services. There has been a slight change in comparison to last year, when only 61% were using one or more external administrators.

Fig. 64 How many external fund administrators does a manager employ?

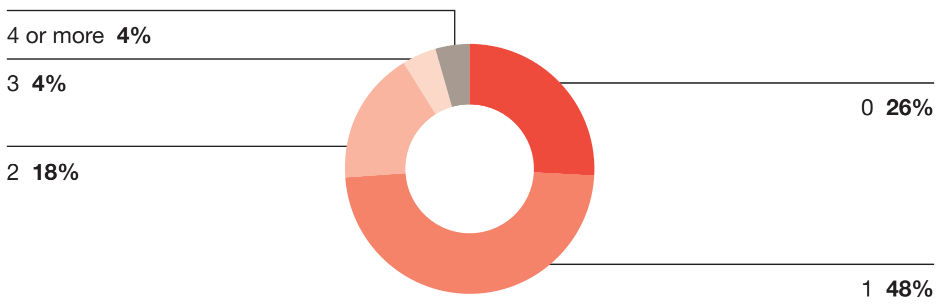
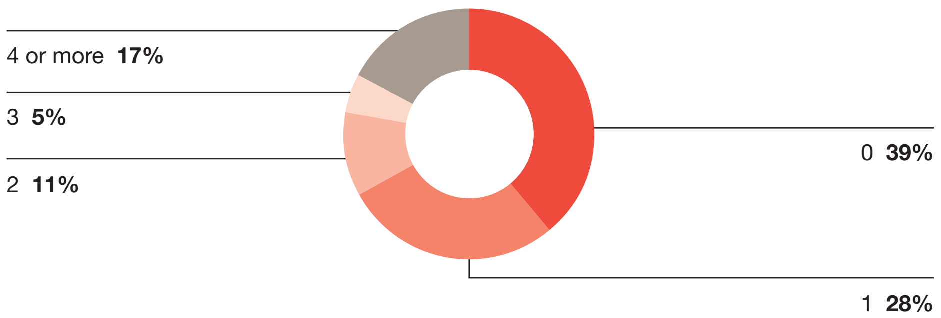


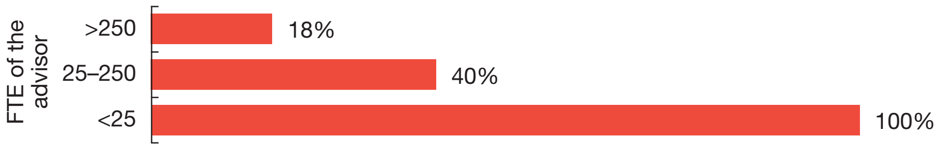
Fig. 65 Number of administrators as surveyed in 2014



The changes in comparison to the previous year are similarly clear when broken down by size class: in this case, we find a more harmonious picture than in the previous year. Outsourcing among small managers in this year's group of participants is lower (80% following 100%), but significantly higher in the group of medium-sized and large managers (75% following 40%, and 60% following less than 20%). We see the initial reasons for these effects, however, in the growth in the group of participants and not in a short-term market change.

Fig. 66 Have back office functions been outsourced to a fund administrator?

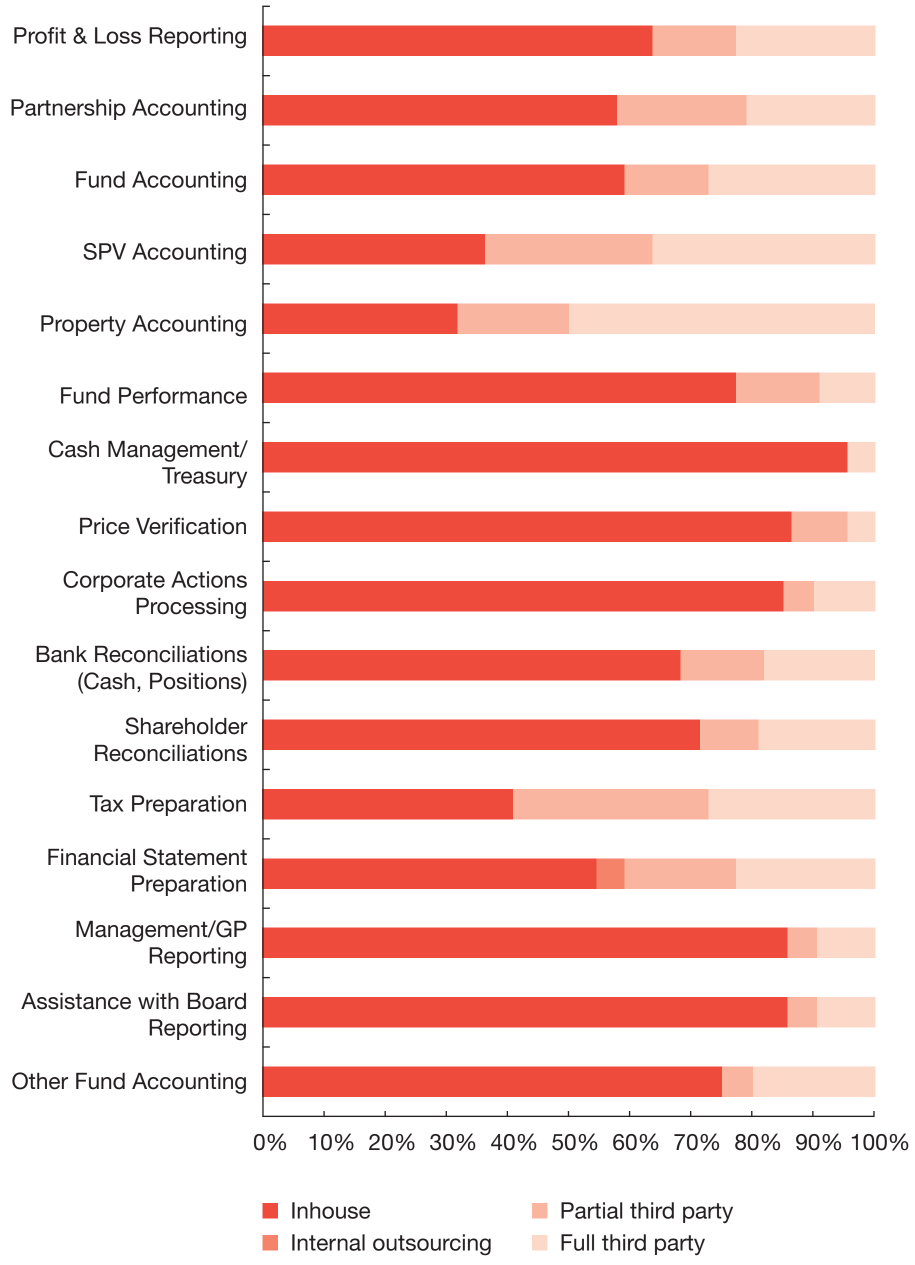
Fig. 67 Back office outsourcing as surveyed in 2014



4.1 Fund accounting and administration

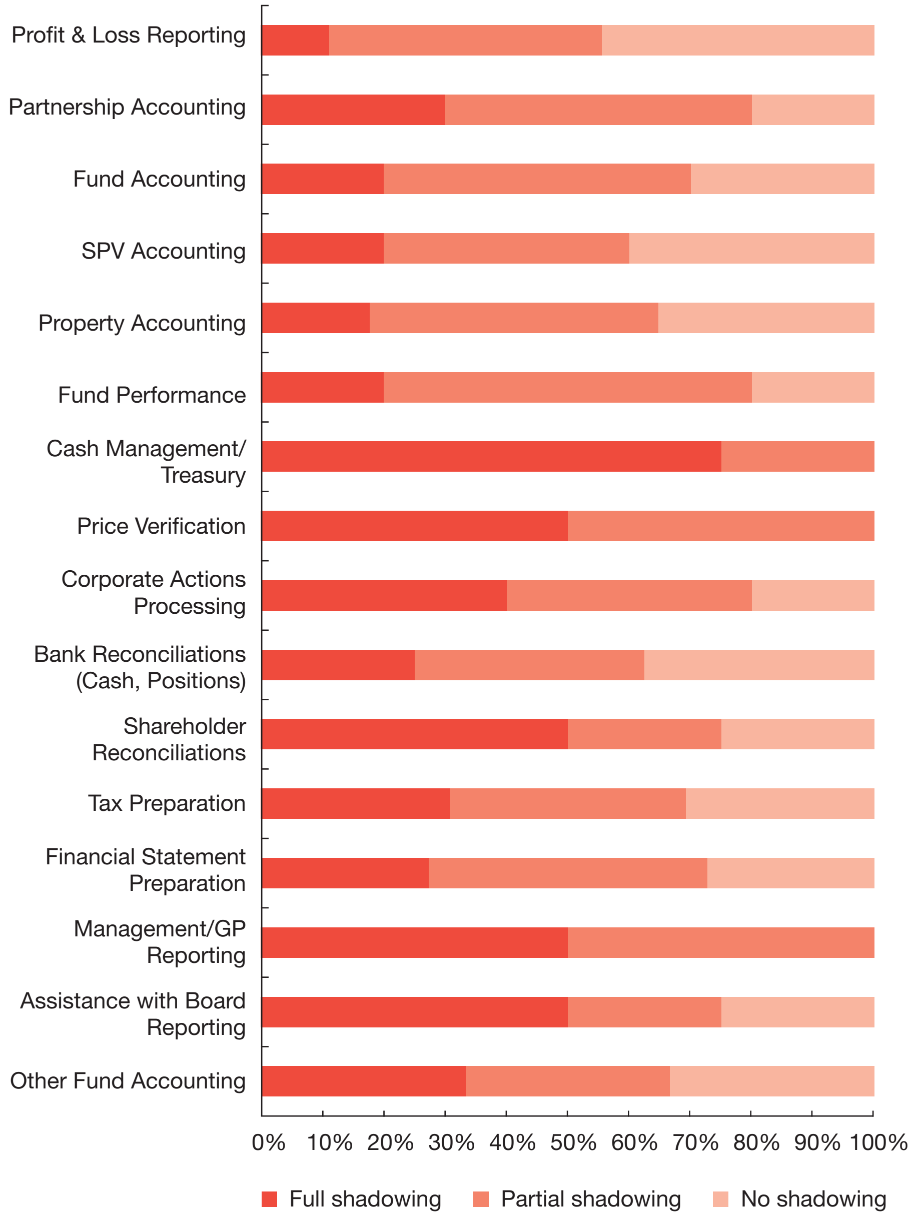
We will now analyse outsourcing practices among individual important processes of fund accounting/administration. The graph clearly shows the high level of internal activity in the group of participants. Whilst more than half of the managers outsource SPV and property accounting, fund and partnership accounting are provided internally in about 60% of cases. Of the other performance areas, only tax preparation was subject to a high level of outsourcing.

Fig. 68 What services have been outsourced?



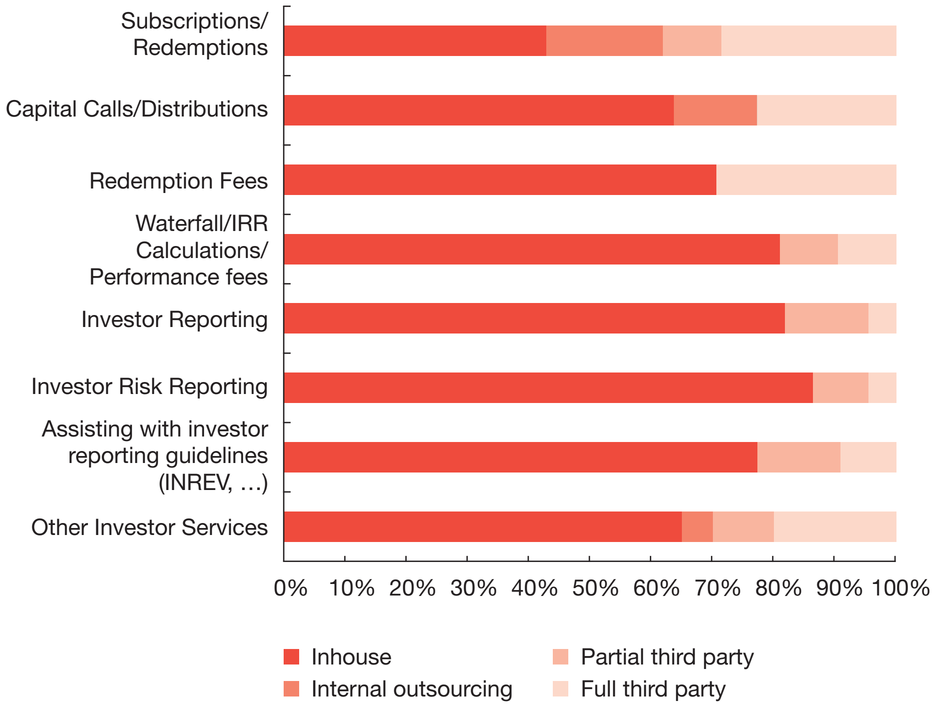
Of the managers who outsource, a large proportion monitor the provision of services closely through complete or partial shadow accounting. Close supervision takes place in particular in sensitive areas of cash management and treasury, price verification and management/general partner reporting. There is less supervision and more confidence in external service providers in the case of classical accounting tasks.

Fig. 69 What level of shadowing is performed by the advisor?



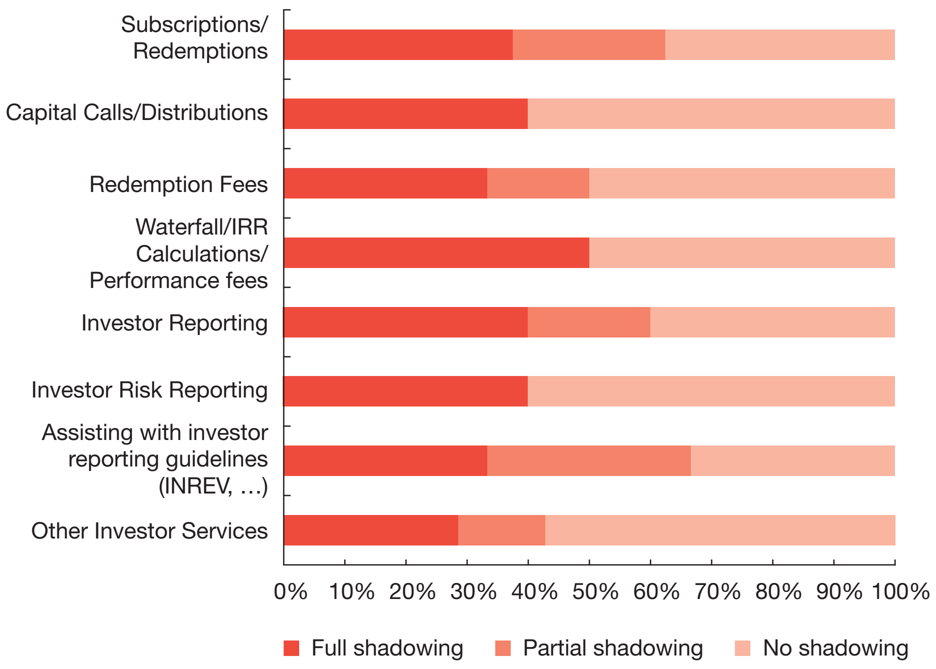
4.2 Investor services

Fig. 70 Have the following investor services been outsourced?



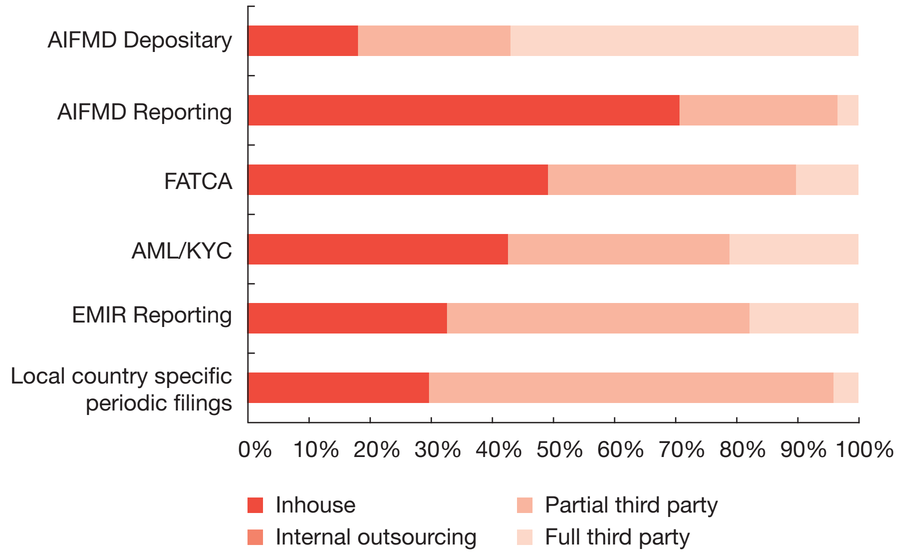
Similarly, 60% or more of the managers surveyed rely on internal activity or use internal outsourcing at the interface of the back office to the investor. Performance fee calculation and investor reporting are provided internally by more than 80% of participants. Around 50% dispense with shadowing, insofar as investor services are outsourced.

Fig. 71 What level of shadowing is performed by the advisor?



4.3 Regulatory reporting

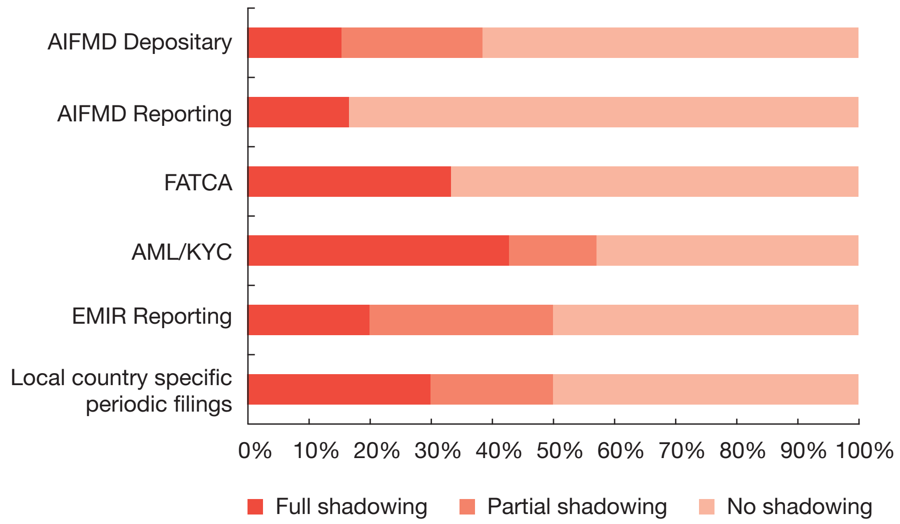
Fig. 72 What parts of regulatory reporting have been outsourced?



The regulatory reporting has become more frequent and complex in recent years. As a consequence, two-thirds of the participants primarily outsource reporting to the AIFMD Depositary and EMIR.

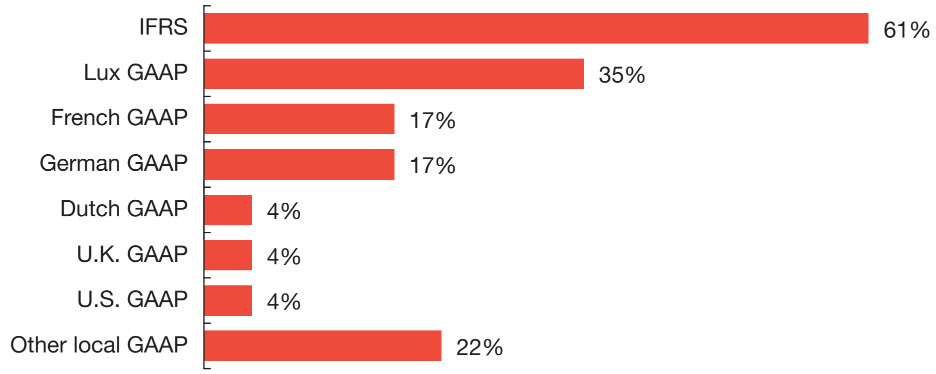
With internal activity exceeding 50%, reporting to supervisory bodies under AIFMD and FATCA, in contrast, are among the areas with less outsourcing. This is surprising in view of the low value-adding significance of these activities, but it is also understandable in view of the high level of automation achievable with the AIFMD reporting, and the dealing with confidential customer data in case of the FATCA. The level of shadowing in the case of reporting is lower than in other performance areas. On average, less than half of the outsourcers carry out partial or complete shadowing.

Fig. 73 What level of shadowing is performed by the advisor?



4.4 Financial reporting

Fig. 74 What is the basis of accounting for the funds' financial statements?

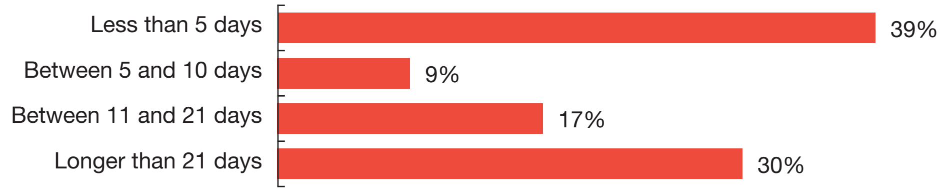


Financial statements for funds are most often prepared in accordance with the international financial reporting standards (IFRS). It is not surprising that Luxembourg's generally accepted accounting principles were used by 35% of the managers, as a result of the dominance of the Luxembourg fund domicile.

Fig. 75 How frequently is financial reporting performed?

The majority of managers report on a monthly or quarterly basis. Annual and half-yearly reporting cycles are the exception throughout Europe.

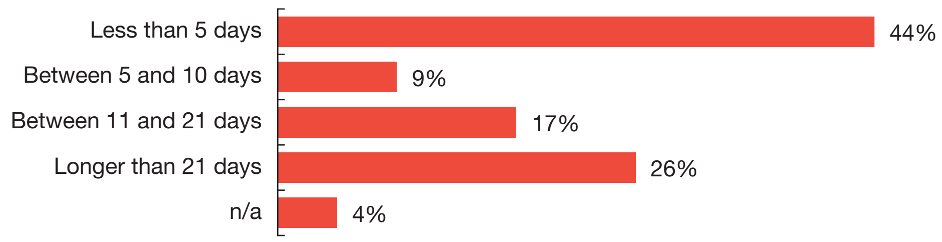
Fig. 76 What is the average number of business days to perform the period end close process?



Two out of five managers can perform the process of period end closing for a fund or a mandate within five days. At the same time, there is also a large number of managers that need more than 21 days for reporting, some 11% more than in the previous year.

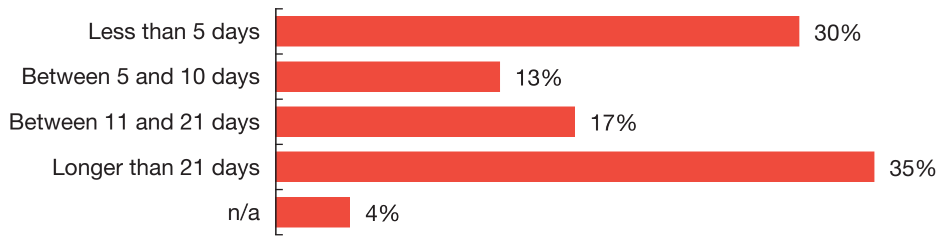
Does size really matter? This appears to be the case with period closing. Many smaller managers require longer for the calculation of the NAV than medium-sized and large managers. The secret to speedy delivery no doubt lies in well-established processes and a higher degree of automation.

Fig. 77 What is the average number of business days after the period end to issue preliminary NAVs?



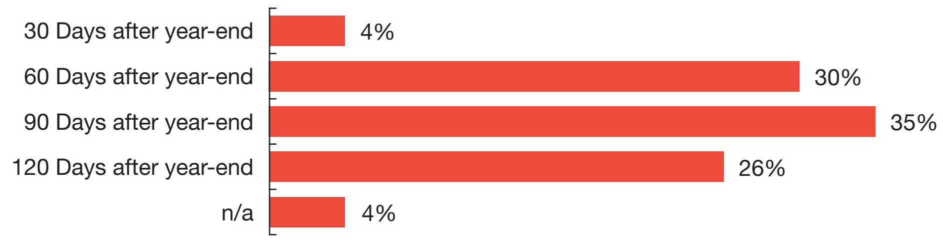
Nearly half of the managers (44%) are able to prepare a preliminary NAV within five business days on average, 12% more than in the previous year. Less than one-third requires more than 21 business days for this. If we take a closer look here, medium-sized and large managers are in the forefront once again. And if we relate the data to company headquarters, the leading group is made up of German managers, followed closely by managers with headquarters in France and Luxembourg.

Fig. 78 What is the average number of business days after the period end to issue final NAVs?



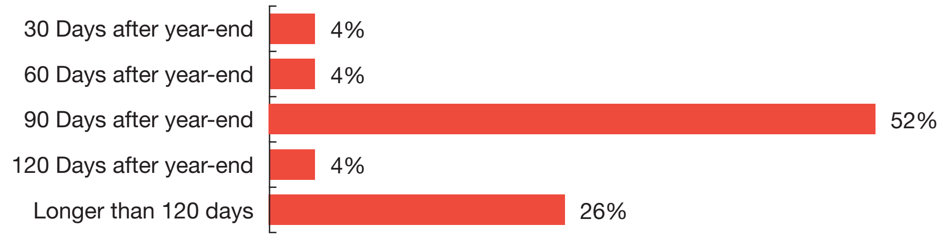
Whereas last year one in four managers were able to produce an NAV report within five days, this year that figure is nearly one in three. Nevertheless, there is also a large number of managers who require more than 21 days for reporting NAV.

Fig. 79 What is the expected timing for issuance of audited financial statements of directly managed funds?



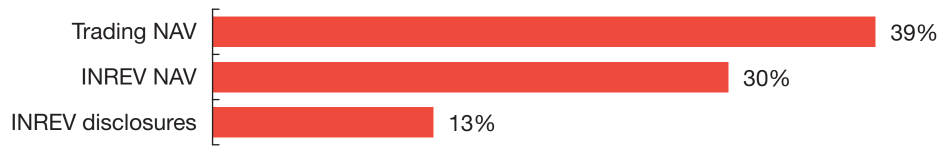
More than two-thirds of the managers expect to issue audited financial statements within 90 days. The survey participants that aim to be even faster seem to be the smaller managers.

Fig. 80 What is the actual timing of release of the majority of the annual audited financial statements for the most recent fiscal year-end (directly managed funds only)?



In terms of actual timing, however, less than two-thirds of the participants were able to publish the financial statements of their funds within 90 days. One-quarter of survey participants even needed more than 120 days for fund financial statements, and therefore more time than expected.

Fig. 81 Does the reporting include ...



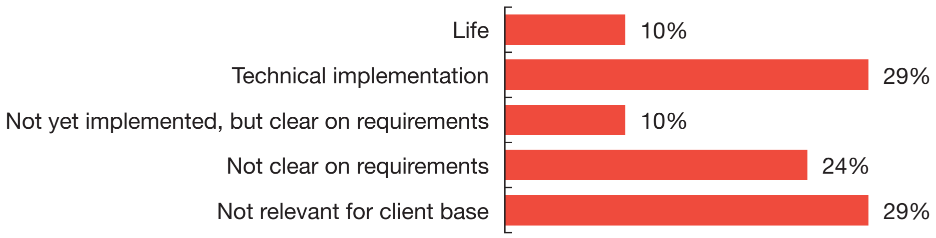
Nearly half of the managers also publish trading NAV in their financial reports. This group primarily consists of managers from Luxembourg, Germany, Spain and the UK. Around 37% also include the NAV determined according to INREV in their report; this practice is most widespread among managers from Spain, the UK and Luxembourg. In contrast, only a few of the companies include the complete INREV disclosures in their reports.

4.5 Investor reporting

Above all, investor reporting addresses institutional investors at home and abroad. The demand for specific information is constantly growing. Decisive advantages in competition can be generated as a result of cooperative, open and proactive investor reporting. Investor reporting therefore represents an important element for maintaining customer relations and the acquisition of new customers. A holistic approach is required in this respect in order to build up a long-term relationship based on trust.

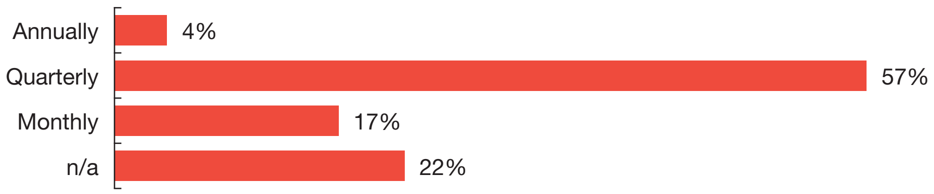
With the introduction of Solvency II, the demand is growing in the sector of institutional investors for greater frequency and for shorter deadlines. Managers will have to come to terms with this in future and modify their reporting landscape to meet the new challenges.

Fig. 82 What is the status of preparation for Solvency II reporting to insurance clients?



Only 10% of the participants had implemented Solvency II reporting at the time the survey was conducted, and only a further 30% had started the technical implementation.

Fig. 83 Investors letters are sent ...



Nearly half of the managers send investors an investor letter every quarter, with 17% of the managers doing so every month.

Fig. 84 Performance information is provided ...

More frequent reporting is provided on performance. One in two managers already provides investors with a quarterly report on performance, which is 13% more than in the previous year. Likewise, the percentage rate of monthly performance reporting has also increased from 22% to 35%. At the same time, nearly 60% also report on performance at property level.

Fig. 85 Performance information and analysis for property investments is regularly provided at granularity of ...

In most cases, managers' individual reporting formats are used for quantitative reporting. Standards such as the INREV SDDS play only a subordinate role in investor reporting to date. Precisely because of the increasing reporting intensity resulting from Solvency II, a far-reaching harmonisation of quantitative reporting at European level would undoubtedly be most desirable.

Fig. 86 INREV SDDS is presented ...

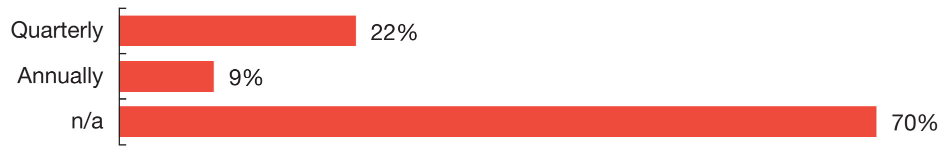
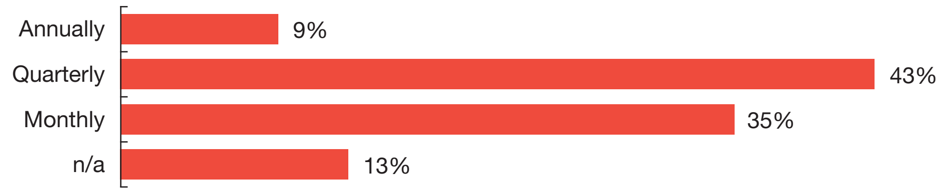
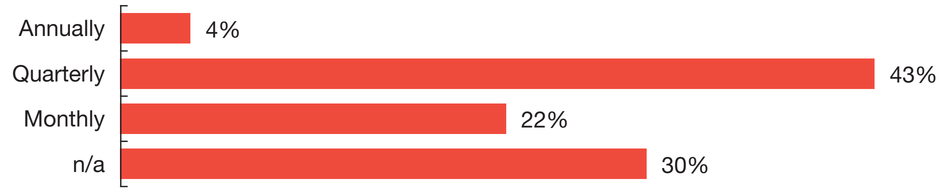


Fig. 87 Capital account statements are issued ...



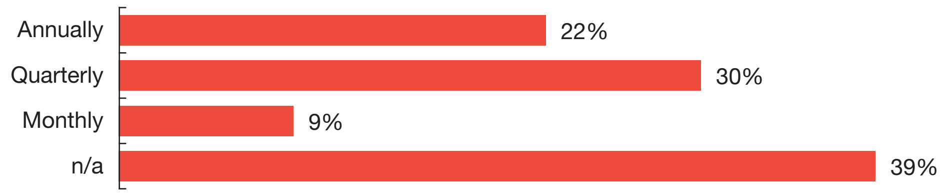
More than three-quarters of the managers stated that they submit a report of capital account statements to their investors every quarter or every month. In comparison, the number of managers who only inform their investor about this annually is very low.

Fig. 88 Unaudited financial statement are disclosed ...



Around 70% of the managers also disclose an unaudited financial statement to their investors. 22% of the managers even informs their investors on a monthly basis. Only 30% do not offer this service at all.

Fig. 89 Tax estimates are provided ...



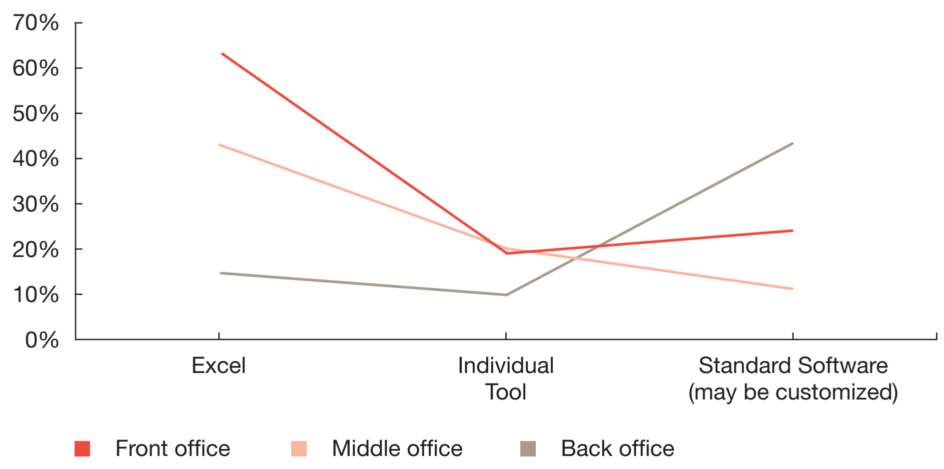
As in the previous year, around 60% of the managers provide their investors with estimates on taxation.

5 Technology

The use of IT is without doubt of great importance in all areas of the value chain – whether for the provision of data and information for analysis, decision-making processes and controlling, the efficient design of interfaces to partners, or for the purpose of automation. The digitalisation of further parts of private and business life will further increase the significance of IT. New skills (e.g., data mining) and more flexibility and speed in deploying new solutions will be necessary to accomplish this.

For this reason, we have conducted an initial stock-taking of the use of software in the front, middle and back office as part of the last chapter of our survey. In the front and middle office, the software solution of choice is neither a special application nor a proprietary development but rather Microsoft Excel. The back office is more standardised. Business intelligence solutions (BI), client relation management systems (CRM) and – surprisingly – data warehouses are not very widespread.

Fig. 90 What software is used for front, middle and back operations?



Tab. 1 What is the software support for the following processes?

	Excel	Individual Tool	Standard Software (may be customized)
Front Office			
Portfolio Management	61%	22%	30%
Planning and Forecasting	65%	4%	17%
Investment Analysis	61%	30%	22%
Middle Office			
Risk management	44%	17%	13%
Valuation	39%	22%	9%
Back Office			
Fund accounting	13%	9%	44%
Partnership accounting	17%	13%	30%
SPV accounting	22%	9%	48%
Property lease accounting	9%	9%	48%
General ledger	4%	9%	48%
Regulatory reporting	30%	9%	30%
Other			
Business Intelligence	4%	4%	22%
Data warehouse	13%	17%	22%
Client relation management	4%	22%	22%

"These results are an urgent call for more investments into the digital infrastructure and capabilities of the real estate asset management industry."

Credits

Credits

Lead researchers and authors

Jürgen Buchelt, MRICS
Director, Management Consulting, Real Estate
PwC Germany
Tel: +49 89 5790-6402
E-mail: juergen.buchelt@de.pwc.com

Robert Castelein
Director
PwC Luxembourg
Tel: +352 494848-2159
E-mail: robert.castelein@lu.pwc.com

Executive sponsors

Kees Hage
Global Real Estate Leader
PwC Luxembourg
Tel: +352 494848-2059
E-mail: kees.hage@lu.pwc.com

Susanne Eickermann-Riepe
Partner Management Consulting, Asset Management/Alternatives
PwC Germany
Tel: +49 69 9585-5909
E-mail: susanne.eickermann-riepe@de.pwc.com

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Annett Anschütz
Jürgen Buchelt
Robert Castelein
Jean-Baptiste Deschryver
Inès Dias
Susanne Eickermann-Riepe
Marlène Gaszynski
Tommaso Grassi
Kenneth Iek
Laura Iftime
Geoffroy Jonkcheere
James Mee
David Nadge
Hélène Ollivier
Rolf Wiggert
Beltrán Martínez Zarco

If you would like to discuss any of the issues raised in this survey in more detail, please speak with your usual PwC contacts or anyone listed below.

Uwe Stoschek
Real Estate Leader EMEA

Kinga Barchon
Real Estate Leader CEE

Wolfgang Vejdovsky
PwC Austria

Ann Smolders
PwC Belgium

Geoffroy Schmitt
PwC France

Jochen Brücken
PwC Germany

Elisabetta Caldirola
PwC Italy

Amaury Evrard
PwC Luxembourg

Jeroen Elink Schuurman
PwC Netherlands

Guillermo Massó
PwC Spain

Arne Engvall
PwC Sweden

Kurt Ritz
PwC Switzerland

Craig O. Hughes
PwC United Kingdom

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