

# Inbeeld

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| 07

## 04 Looking ahead

How sustainability, the Internet and risk aversion are defining the market.

## 09 It's all in the numbers

Smart monitor helps Bouwinvest in its decision-making.

## 14 New reality

There are no safe havens: investors need to spread the risk.

## 20 Opportunities in Japan

After a decade of recession, the real estate market still offers good opportunities.

A photograph of three business professionals standing on a rocky, brush-covered shore. On the left, a woman in a dark coat and a vibrant purple scarf looks towards the camera. In the center, a man in a dark coat and a yellow tie looks towards the right. On the right, a man in a grey suit and a purple tie looks towards the right. The background features a body of water, a long pier or breakwater, and several wind turbines under a cloudy sky.

‘International investors in search of safe havens’



# Foreword

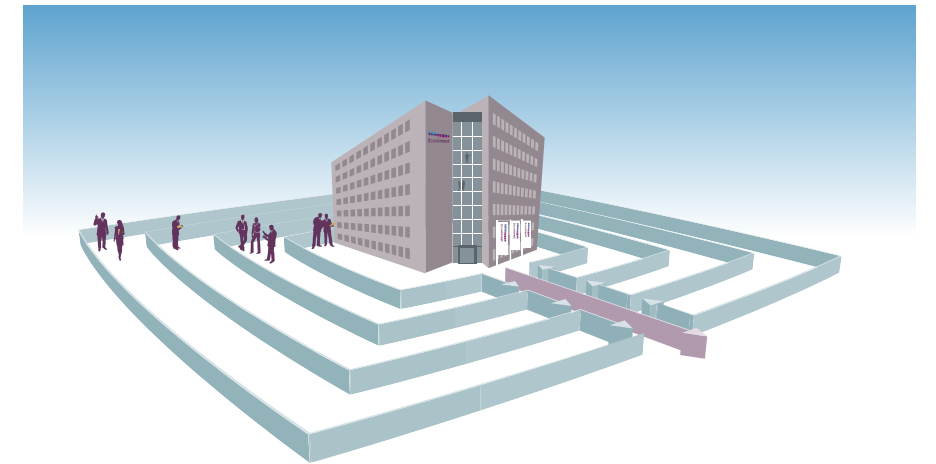


### Safe international investments

This issue of Inbeeld, the Bouwinvest magazine, is all about international investments in real estate. It has become apparent that investors worldwide are looking for safer ways to invest and spread their risk these days. Alternative investment categories like real estate are making their mark more and more. Residential investment represents one such safe haven. With net yields of 4% and increases in rent levels of 3%, nobody will become rich overnight, but it represents a form of investment that fits in well with the objectives of pension funds, providing them with a sound base for their portfolio. At home, in the Netherlands there are calls for pension funds to invest in Dutch mortgages. This is not a new idea. In the past you had mortgage bonds and, in my opinion, it is a phenomenon that would fit in with the present day. In this scenario,

mortgage banks would issue bonds with the mortgages lent representing the security. The idea of bonds fits in well with the long-term character of pension funds' investments and they are both secured and liquid. Although investors have become more cautious, we should be wary of becoming too risk-averse and, in turn, miss out on opportunities and yield. By making judicious choices, it is possible to create opportunities in difficult markets, such as Japan, as Bouwinvest has demonstrated in the office market in Tokyo. With the help of Bouwinvest's Global Market Monitor, it is now possible to identify where opportunities lie, but also to establish what the alternatives are and how the risks are spread.

Happy reading!  
*Dick van Hal, CEO*



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## 'Delivering customised solutions in terms of yield and risk'

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diversification into real estate and other investment categories.

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Despite the crisis, Japan is still an immensely wealthy country. Nevertheless, investing in Japan requires detailed knowledge of the market. Growth may have bottomed out in the provinces, but Tokyo continues to grow.

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*Risk, Compliance and Internal Audit*

After the latest case of fraud in the real estate sector, there has been a sea change in attitudes. Leaving aside the tougher regulations, organisations are realising that this kind of behaviour is no longer acceptable. Serious consideration is now being given to risk, compliance and internal audit.

- 1 Risk management – proactive and facilitating
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- 3 Internal Control – identifying risks

### And more

*Annette Birschel's column*



## TRENDS IN REAL ESTATE

# Shift towards quality

In the wake of the financial crisis, the real estate sector has been having a turbulent time, the end of which does not appear anywhere in sight. Events have been following each other in quick succession. In addition to macro-economic developments, a number of underlying trends can be identified that will have a defining effect on the sector for the next few years.

Stephen Tross, Friso Berghuis and Robert Koot, Bouwinvest

Key themes that we will have to keep a keen eye on in the coming years include risk aversion amongst investors and a shift towards top tier real estate; demands on the part of investors and tenants with respect to the sustainability of buildings; the rapid emergence of online shops; and stricter statutory regulations. In addition, there is said to be a shift in investments within and between regions and market segments.

## Regions

Growth is mainly apparent in Asia and America, while Europe lags behind. Although Asia experienced a brief downturn as a result of the global crisis, it soon rallied. The dip lasted longer in America, but a slow recovery is apparent there, while no one is quite sure whether Europe has bottomed out yet. In Europe, the divide between the stronger economies of the northern countries



and the weaker ones in the south is becoming increasingly apparent. Greater levels of risk aversion are evident among investors, who are seeking for safer havens. In the past, the bond market was always considered to be one such safe haven, but bonds no longer offer adequate returns, so investors are now casting their eyes towards other investment categories, such as real estate. The emphasis is on quality real estate, a category for which financing is still available. Secondary assets, on the other hand, are far more difficult to sell and lease. This trend has been on-going for the last few years, with an increasing divide apparent between top-tier assets - which remain popular - and the B and C locations, which are more difficult to finance and which suffer globally from vacancy and declining rent levels.

In general it can be said that the world has become more global, with a greater number of worldwide players in the market, leading to global shifts in capital. In doing so, investors examine the general state of the occupier market. In Europe, this leads to capital flows which means, for example, that the market in London rises more quickly than in the Netherlands, where the market generally responds more slowly and is less volatile. In other parts of the world, such as Australia, growth continues apace. The office market in Sydney and Melbourne is subject to a completely different set of dynamics: there is economic growth, availability of raw materials and an increasing population as a result of immigration.

It is particularly important at this time to maintain a focus on differentiation and look closely at the different countries within a region or sectors within a country. Take Asia for example, where Japan cannot be compared with China, in the same way that the office market cannot be compared with the retail market.

### Sectors

The prospects in each of the different sectors are diverse. Major differences exist caused by an oversupply when market demand declines in a particular segment. The decrease in economic growth and the resultant drop in demand for jobs means that the office market will remain difficult. That is certainly the case where much new office space has been built. That's clearly evident in the Netherlands: in many parts of the country, there is an oversupply of office space. This development is reflected in the investment figures: in the Netherlands, there is a lot less being invested or traded in the office market. Conversely, a large part of the investment portfolio is taken up by the residential market. Among investors, there is a clear shift towards safe investments, such as rented accommodation, which is the segment in the Netherlands where supply scarcities are the greatest.

### Sustainability

Another important trend that has emerged in recent years is the focus on 'green' buildings.

## SUSTAINABILITY

A number of initiatives are being taken in the real estate sector in order to bring about standards that will help define the sustainability of real estate, real estate funds and portfolios.

GRESB is a joint initiative being undertaken by a number of national and international pension funds and real estate investors, in which real estate funds and fund managers undergo evaluation on the basis of a large and uniform number of sustainability guidelines and social investment guidelines.

The aim is to identify and implement best practices with respect to sustainability in order to increase shareholder value. More information can be found at [www.gresb.com](http://www.gresb.com).

BREEAM NL has been developed by the Dutch Green Building Council (DGBC) in collaboration with a number of partners in the Dutch real estate sector, including Bouwinvest. BREEAM sets a standard for a sustainable building and then specifies the performance levels attained by the building in question. The idea is for buildings to be analysed and improved. More information can be found at [www.breem.nl](http://www.breem.nl).



Workplace6, 18,000 m<sup>2</sup>  
waterfront office complex  
in Sydney's Pyrmont GPT  
Wholesale Office Fund

This is not just aimed at the sustainability of new buildings, but also on bringing sustainability levels up to scratch in existing premises. Tenants are imposing ever-increasing demands when it comes to the sustainability of buildings and, although the exact financial effects of green investments have not been quantified (data for this is currently being collected), owners cannot afford not to pay attention to this aspect. If a property is not sustainable in the long term, there is a risk that the lease will no longer be renewed or that the premises become unviable.

Up until now, sustainable construction focused on the cost aspects, in particular targeting lower energy costs. In the current office market, an A energy label, in relation to a G label, can mean the difference between 100% occupancy and 100% non-occupancy. Certain requirements are expected of a label from the various parties. Public-sector parties are already doing this and many corporates have sustainability targets included in their annual CSR reports, which obliges them to operate in accordance with these. It is difficult to establish the exact link between effective leasing and occupancy levels to the energy label, but a number of studies show a positive correlation. On a day-to-day level, it is

clearly an important issue and one that enjoys wide support in the market.

### Internet

In the retail market, there is an identifiable shift away from physical shops to online shopping. Increasing online sales are having an effect on the shopping behaviour of consumers. As far as retail assets are concerned, the location itself is increasing in importance. The shopping experience is key to attracting consumers to shopping centres. Streets on the periphery of major centres have been experiencing problems for a while now. In some towns and cities, it is only the streets at the heart of the central shopping district where demand is sufficient. This is not just happening in the Netherlands, but internationally too. The rapid rise in the number of webshops is not only affecting retail assets, it is also having a significant impact on logistics and on logistics assets.

### Increased regulation

The call for more stringent statutory regulations and tighter supervision on the financial sector has also had an effect on the real estate sector, first and foremost because banks are now hard at work building up their financial reserves, as a result of stricter solvency requirements set down in Basel

III. This means there is less money available for loans, including to the real estate sector. The real estate sector has to deal with the regulator first hand when it comes to using debt capital for financing, i.e. leverage. In the past, this debt was widely used, but now limits are being set, with maximum limits now being set for the amount of leverage that can be allocated. The subject matter is complex: many aspects are bound up in leverage and all these aspects must be viewed in combination in order to determine the risk. For example, 20% leverage on project development activities for hotels in India might represent a much higher risk than 40% leverage on a stable Dutch-based residential portfolio in core regions that generate stable levels of income. The challenge here is for the regulator, who has to draw up neutral rules and make no exceptions in order to arrive at regulations that are in line with the sector, so as to arrive at an all-embracing and functional risk-management framework.

#### Long-term horizon

The demands financial regulators are placing on the financial reserves of pension funds are having a clear impact on the allocation of investment. The increased risk aversion among pension funds is leading to a reduction in liquid and high-risk capital investments. Care must be taken not to overdo it and that pension funds invest too little of their assets in high-yield and more illiquid investment categories with a slightly higher risk profile. The investment horizon must be in line with the obligations of the fund. The most

important conditions for lowering the risk are diversification into other countries and sectors, a balanced share between listed and private equity, investment in new or existing real estate and a long-term investment horizon. The use of leverage must tie in with this in terms of diversification and currency.

Investors with a long-term horizon can invest with complete disregard to the economic cycle, and that yields opportunities. Over the last five years, almost every sector has had to reevaluate downwards. Slight downward readjustments may follow in 2013, but in the long run, that is over a period of ten or more years, real estate will be able to offer attractive returns again. In addition to the direct component, rent, the expectation is that positive developments will be experienced in terms of value.

#### Future

At the the sector is in a state of delveraging. Parties are trying to decrease their debt by disposing of real estate. This provides opportunities for players in the market who work with equity capital, enabling them to participate in projects at attractive prices. Once the leverage bubble has deflated, it will be the stronger players that survive, and for them there will be exciting opportunities. In the Dutch market, the supply side is growing, with many excellent products coming on stream. Parties with an urgent need for liquidity are now selling off quality assets for attractive prices. For example, in the last year, listed real estate companies cashed in more so than in previous years. In Europe alone this amounted to up to 20 billion euros, enabling them to recapitalise and take full advantage of these opportunities.

*Stephen Tross sits on the management board since 2010 and is Director of International Investments at Bouwinvest. Friso Berghuis has been Strategic Investment Analyst at Bouwinvest since 2010. Robert Koot has been Research Manager at Bouwinvest since 2012.*

#### BASEL III

On 12 September 2010, regulators and central banks reached an agreement on new rules and regulations for financial institutions: Basel III. Basel III's central message is that banks must hold on to much more capital and liquidity with respect to their outstanding investments than until now. Basel III will be gradually introduced from 2013 onwards. By 2019, the rules must be fully enforced.

#### GLOBAL MARKET MONITOR ENABLES CUSTOMISED CHOICES

# Taking decisions based on facts

The worldwide financial crisis has also had a real impact on the international real estate markets. Investors who were previously used to working with high levels of leverage have been faced with liquidity problems as a result of the banking crisis, leading to forced disinvestments. This has brought about new prospects for parties investing large amounts of equity capital and with a strong balance sheet.

Bouwinvest is a party that is ideally positioned and ready to take full advantage of the opportunities that the market presents. "Bouwinvest's strength lies in the fact that we have our own assets and capital at our disposal, which gives us a much better springboard from which to expand", explains Stephen Tross, member of the management board and Director of International Investments at Bouwinvest. "We are a global player with an international outlook, which enables us to switch between the various markets. We are also doing this in our allocation. We are not only able to manoeuvre rapidly between the various markets, but also between the sectors within these markets. Our scale of operations allows us to bring about effective diversification in our portfolio. We invest directly in real estate, but also indirectly through listed and non-listed assets."

#### Allocations and customisation

Nowadays, it is all about delivering the right allocation of investments and a customised service for shareholders. When picking out the most attractive markets and investment opportunities, Bouwinvest has recourse to the 'Global Market Monitor'. This monitor, developed in-house, consistently brings together all the experience, expertise and data from within the organisation and the macro-economic and market know-how of external experts in a single model. It makes it easier to make well-founded investment decisions, taking into account all the possible alternatives in the evaluation.

The Global Market Monitor focuses worldwide on countries that are 'investable', that is, countries where it is possible to invest in the right kind of

real estate, and in markets which meet the internal guidelines and investment beliefs of the pension fund for the construction industry, bpfBOUW. In this way, markets must satisfy the requirements of transparency and non-corruption. The ESG (Environmental, Social and Governance) conditions are also taken into account. “We do not invest in countries with a dictator. The ESG conditions and our governance set out conditions to which our investments are tied”, explains Stephen. Not all countries are investable. In the Netherlands, Bouwinvest has a large residential

## ‘Nowadays it is all about the right allocation’

portfolio, with assets also in the retail and office markets. Nevertheless, due to the availability, it is not always possible to apply the same level of diversification between these categories abroad. Residential investments are particularly difficult to acquire. In Switzerland, it is generally quite difficult to purchase real estate as a foreign investor, but the market itself is attractive. The Swiss residential market is extremely stable, has a low risk profile and - related to this - also has a low yield. For foreign pension funds, this could be an attractive investment product.

In the rapidly emerging markets, investment in residential real estate is mainly linked to the development of housing, which is another market in which investors run a project development risk. The Chinese market offers many investment opportunities, but nearly all of them are in the development stage where capital is required. It is more difficult to get hold of operational property in China, but the situation is now changing.

### Ranking

The monitor allows profiles of specific countries to be examined, as well as to zoom in on regions or urban conurbations within countries and sectors. “We have created an extra tier in the system. For

example, one particular country might have a lower rating because of a relatively low population and economic growth, but it may have a specific sector which is of interest”, explains Robert Koot, Manager Research at Bouwinvest.

The Global Market Monitor gives a presentation of markets on the basis of the most important (available) indicators. Countries and cities are ranked according to macro-economic data, such as economic growth, population growth, unemployment, inflation and international indices for transparency and corruption. Historic data is also required to support the stability of these indicators. Depending on the investment profile and type of investment, the various indicators are then taken into account and - on the basis of this weighting - a definitive ranking of countries and regions emerges.

Using the same methodology, but augmented by market-specific data, such as non-occupancy, rent and initial yield levels, the various sectors, such as the office market, retail market, logistics market and residential market, are ranked per country or per region.

“Bouwinvest uses a kind of standard scenario for the monitor, which is based on macro-economic data and demographic statistics which are reasonably predictable. We also buy in third-party economic data”, Robert adds. “We include the latter for the most part, but we glance a critical eye over it. We also purchase real estate data from other specialised parties and match that to our own information. A general ranking then follows, based on the attractiveness of the markets and sectors that have been included in the model.”

In practice, explains Friso Berghuis, Strategic Investment Analyst at Bouwinvest, it works as follows: “We pick out the most attractive markets first and then we look at how we might invest. This is based on the availability of managers, listed property, possible joint ventures or club deals in the different regions, taking into account the preconditions of the shareholders and the

investors. We deliver a customised service to shareholders in terms of yield and risk.”

The market monitor not only looks back, but looks forward too. “We look at the historical situation, going back as far as 10 to 20 years ago. We use this data to identify characteristics, such as the stability of specific markets. It’s important to us, because we look mainly at core countries and core products. By applying a core investment profile, we can focus on the safest category of real estate, where little or no leverage is involved. However, the model also includes an expected prognosis for the coming five years. The latter is even more important because it gives us an idea of the best moment to (dis)invest”, Robert concludes.

### Governance

The relative ranking model is constructed in such a way that a classification can be made based on various insights by varying the weighting of specific indicators. This gives us the possibility to interpret the final result separately from the ranking. “It is a form of accountability as to why a particular choice has been made, a kind of retrospective validation”, adds Stephen. “It’s part of good governance to apply transparency to the knowledge you had at your disposal and make clear that this knowledge has been applied when

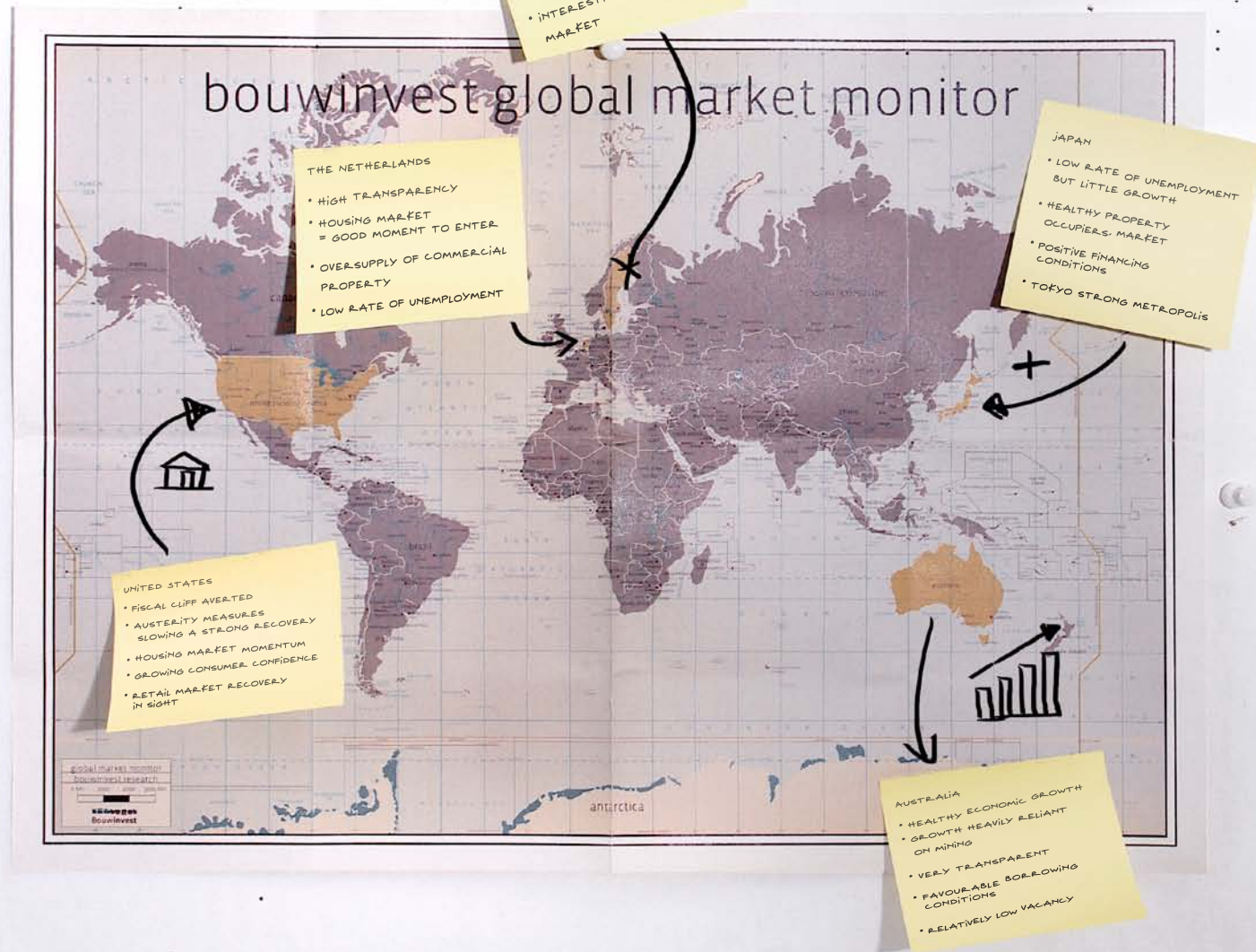
taking the decision to invest. However, all the decisions start with the investment beliefs and on the basis of these a specific policy can be drawn up that fits like a glove. In this way, it enables you to address the issues of the day.” Robert sees the Global Market Monitor first and foremost as an indicative instrument. “It doesn’t replace common sense, instead it’s a method to bring about a transparent discussion, not one which is based on newspaper headlines.”

## INTERNATIONAL INVESTMENTS

Bouwinvest invests in real-estate funds in Europe, North America and Asia. The difficult economic circumstances in Europe have led to a greater allocation of assets to Asia and America, at the expense of Europe. In the future, 40% of the portfolio will be invested in Europe, 40% in the US and 20% in Asia. Although expectations for Asia are positive, at the moment the region still has a high-risk profile and the markets still have a lot to prove. Bouwinvest is a core investor, with investments mainly in stable markets which are mostly situated in Europe and America.







“ Delivering customised solutions in terms of yield and risk ”



# Safe havens not always safe

## RISK DIVERSIFICATION STILL ESSENTIAL

*Wylie Tollette, Franklin Templeton Investments*

The financial markets have experienced several crashes in the past five years. This has resulted in rapid and drastic value reductions in various investment categories and has eroded investor confidence in managing risks through a good diversification of investments in traditional markets. At the moment, we notice that investors are very risk-averse. Many are looking for safe havens. However, this risk-averse attitude is worsening rather than lessening the problems investors will be facing in the long term.

Due to the financial crisis, both institutional pension funds and private investors looking to preserve their accrued pension savings are facing a widening gap between their future commitments and future revenue and assets. The financial crisis has reduced the value of assets, but not those of future commitments. In our view, relying on very risk-averse investment, which leads to lower yields in the investment mix, will contribute little towards narrowing this gap.

### Embedded risks

In addition, the safe havens all investors are all looking for are not as safe as they assume. So-called safe investments, such as the U.S. dollar or U.S. government bonds, have a number of embedded risks. For example, the explosive growth of the money supply in the US since 2008 has exposed the dollar to inflation risk. While we cannot be certain when this inflation will occur, as investors we should be aware of it.

Government bonds with long-term maturities, perceived by investors as a safe haven, are showing a strong recovery, while interest rates are falling. It appears that interest rates have now hit rock bottom and will probably go up again. This means that investors with portfolios with lots of long-term sovereign debt will be stuck with low interest rates for a long time.

Moreover, it remains to be seen how long the U.S. can keep borrowing. Since 2001, the U.S. raised its debt ceiling 13 times, increasing its debt to 16.39 trillion

dollars by mid-2012. This increasing national debt led Standard and Poor's to downgrade its credit rating for the U.S. from AAA to AA+ in 2011. New downgrades will further reduce the prices of government bonds and the value of these 'safe havens'.

Not only are investors seeking refuge in safe havens, their risk-averse attitude can also be seen in their flight to products with a short-term investment horizon. In this way, they hope to protect themselves from market volatility. Following the events of 2008, 2009 and last autumn, when the value of various assets suffered due to the euro crisis, large groups of investors have shortened their investment horizon.

The role of risk managers of institutional investors, however, is not to prevent risks, but to ensure good management, so that their long-term targets are achieved. Investors should take well-considered risks, keep monitoring them carefully, and ensure that they are adequately compensated for taking risks. A long-term vision allows for time-horizon arbitrage: by basing actions on the long term, investors can capitalise on the reactions of others to short-term market events. This does mean, however, that as an investor you will have to ride out the short-term volatility, which requires discipline and patience. As a risk manager, it is important to be aware of volatility, but also not to be intimidated by it. With a long-term approach, you can capitalise on the short-term vision of others by adding assets to your portfolio that may become valuable in future.

### New reality

Investors will have to get used to the new reality and adjust their timelines in order to benefit from time-horizon arbitrage. Take Warren Buffet, for example: his approach to risk management is to invest in assets he would like to hang on to forever. In my view, twenty years is a reasonable investment horizon for shares, and also for real estate and other less liquid investments. Twenty years may seem like a long time, and most investors will not experience many 20-year cycles during their lifetime, but pension funds and governments have to plan ahead for several generations. Investors should be well aware of timelines and how to fit these into their overall investment mix.

### Diversification into other categories

It's also important to combine your long-term planning with diversification at both the strategic and tactical level. For institutional and private investors, combining diversification with long-term investments is a better approach to ensuring good future performance than over-allocating in 'safe havens'.

Given the recent developments, many investors feel that diversification does not work when all investment categories lose value simultaneously. Nonetheless, diversification is a very important risk management method. Investors should look carefully at the building blocks of their asset allocation and use the right benchmarks that reflect future success, rather than those



## FRANKLIN TEMPLETON INVESTMENTS

Franklin Templeton Investment, officially called Franklin Resources Inc., is a global investment company. The head office is located in San Mateo, California, and the organisation has 30 offices worldwide, offering investment solutions and services in more than 150 countries.

Under the banner of Franklin Templeton Mutual Series, the Franklin Templeton Fixed Income Group and local asset managers are offered investment solutions worldwide for private and institutional investors, pension schemes, trusts, partnerships and other clients.

The firm was established in New York in 1947 by Rupert Johnson, who ran a successful real estate agency on Wall Street. Johnson named the company after one of America's founding fathers, Benjamin Franklin, because he felt that Franklin embodied the principle of thriftiness and patience where saving and investment were concerned.





based on what was successful in the past. Capitalisation-weighted indices, for example, reflect market shifts in the past; equal weighted indices and alternative types of indices are better indicators of future developments.

An important aspect of risk diversification is adding new assets to the portfolio which have a weaker correlation to listed markets, so that the portfolio can be stabilised without triggering an adverse impact on long-term yields. These alternative investment opportunities include real estate, hedge funds and tactical asset allocation strategies. These products react differently than shares listed on the DAX, S&P 500 or FST 100. They have less of a correlation with listed markets, but, unfortunately, they are also sometimes illiquid. Nonetheless, these products are an effective addition to your portfolio.

Generally, there is a relatively weak correlation between real estate and other asset categories. As such, real estate has diversification advantages. The downside of real estate is that it is difficult to determine its exact correlation to other categories. Data on the market value of real estate is not as frequently available as data on listed shares.

In America, the real estate market is slowly recovering after a few difficult years. At the same time, bonds appear to be on the verge of a major shift and share markets will remain volatile. Real estate can be a stabilising factor in your total portfolio mix. Risk diversification is also necessary within the real estate allocation itself. This involves investing in multiple types of real estate, ensuring a good geographical spread, and ensuring that different cash flow characteristics are included in this category.

In the long term, the greatest risk investors run is remaining risk-averse for too long, potentially missing out on promising opportunities. This means that private investors, pension funds and institutional investors would not achieve their set targets and would face a widening gap between their commitments and their available funds. This may well be the ultimate long-term investment risk.

#### WYLIE TOLLETTE

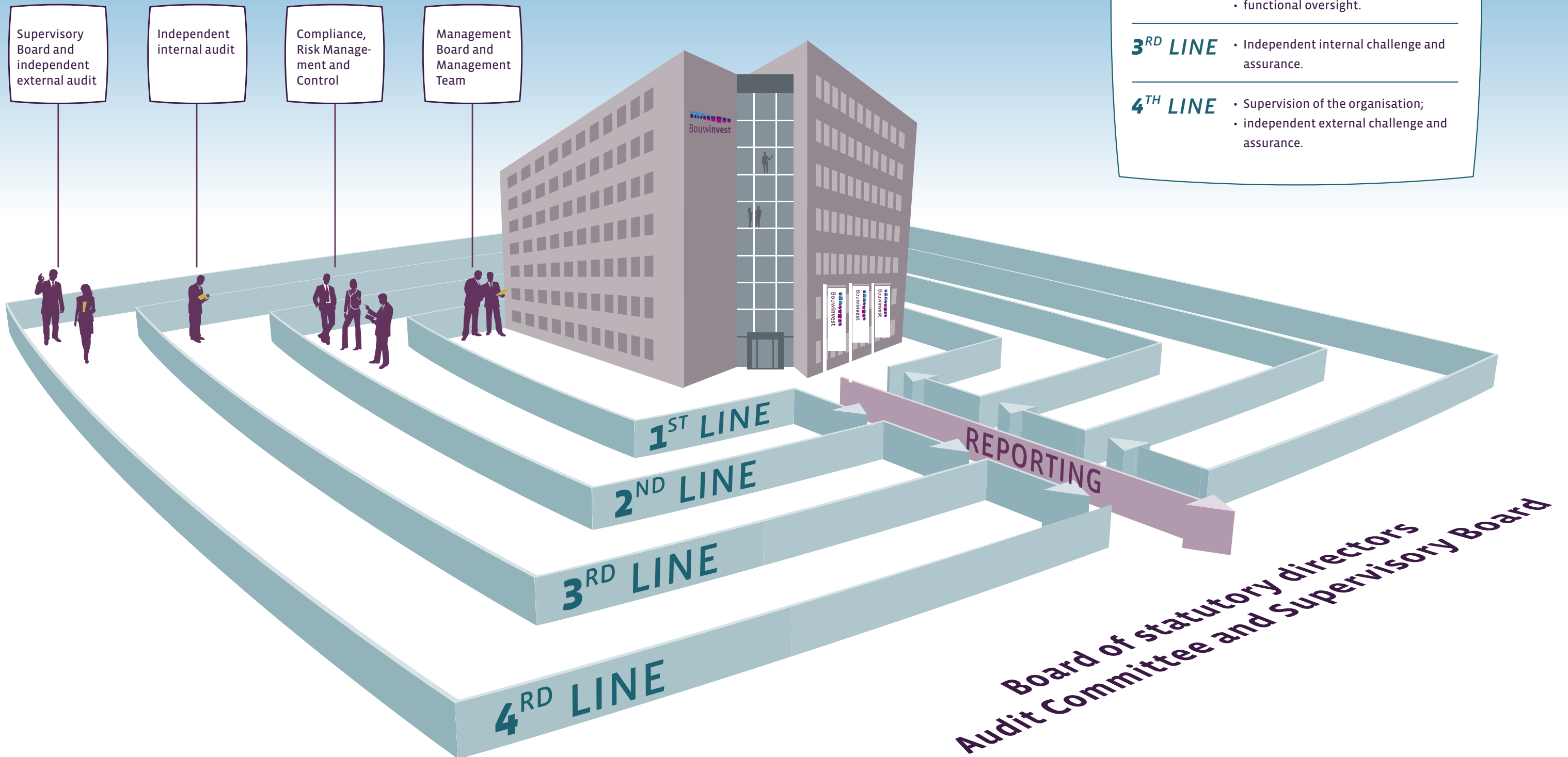
Wylie Tollette, Senior Vice President and Director of Performance Analysis and Investment Risk at Franklin Templeton Investments. Wylie currently manages a team of seventy analysts and risk managers spread out over several cities in the US, Canada, UK, India, South Korea, Hong Kong, Singapore, Brasil and Poland.

Wylie has been with Franklin Templeton Investments since 1995. He started as Manager of Fund Accounting. Since 2004 Wylie is in his current position. Before FTI he worked for KPMG and American Savings Bank.

“  
The biggest  
risk is investors’  
risk aversion”

FRANKLIN TEMPLETON INVESTMENTS

# Bouwinvest Lines of defence



**1<sup>ST</sup> LINE** • Management and control of day-to-day key processes in the organisation.

**2<sup>ND</sup> LINE** • Established compliance, risk management & control framework;  
• policy and procedures;  
• advising, monitoring and reporting;  
• functional oversight.

**3<sup>RD</sup> LINE** • Independent internal challenge and assurance.

**4<sup>TH</sup> LINE** • Supervision of the organisation;  
• independent external challenge and assurance.





IT PAYS TO SEEK OUT SPECIFIC PROPOSITIONS

# Japan offers stable returns

Japan provides a precedent for what may lie in store for Europe over the coming decade. The country has been in recession for the last ten years and national debt is 200% of GDP. That, combined with the effects of an ageing population, means that Japan has low growth expectations.

Jeroen de Grunt, Senior Portfolio Manager at Bouwinvest

### Wealth

Armed with this information, Japan would not seem to be the ideal country to invest in, but Jeroen de Grunt, Senior Portfolio Manager for Asia/Europe at Bouwinvest, believes otherwise. He points out that Japan is still one of the most powerful economies in the world, third only behind the U.S. and China, and draws parallels with Europe. “In Europe we are going through a period of low growth to no growth at all. Japan has been going through the same process for the last decade. However, if you spend any length of time in the country, you would not imagine this was an impoverished society. There might be little scope for growth, but the basis for wealth is in place as usual. Japan is an immensely rich country and the Tokyo conurbation has an economy larger than the Netherlands. Even an economy the size of Osaka’s matches that of Norway.”

Since 2007/2008, Bouwinvest has been active in the Japanese real estate market, operating via special investment vehicles. Global investments have been

grouped into regions, in this case the Asian-Pacific region, of which Japan forms a part. It’s a region of extremes, with a mix of fully-fledged markets in countries like Australia, New Zealand, Hong Kong, Singapore and Japan, and rapidly emerging ones like China. The total Asian-Pacific portfolio amounts to 180 million euros, 13 million of which is invested in Japan. Two additional investments will be added to this in the short term, jointly accounting for around 50 million euros.

### Specific investments

In De Grunt’s view, it pays to seek out specific propositions in Japan. “Looking at it from a macro-economic perspective, or reading the headline news, you’d say it wouldn’t attract any interest at all. After all, there’s no growth, it has an ageing population and the yen is expensive, thus hindering export. But if you zoom in, you’ll notice the big difference between Tokyo and the rest of the country. The city still continues to attract people from outside and Tokyo is expected to keep on growing until 2020. The message is not to look at the wider context, but instead to focus on specific propositions that determine whether or not investments are attractive.”

The inefficiencies of Japanese society are providing some interesting opportunities. De Grunt gives the example of the logistics market, where small, outdated distribution centres are still being used, which is causing problems in distribution further down the chain. “There are big differences between modern distribution centres, occupying 5 to 6 floors, and the old warehouses, thus providing a business case for companies. As a business, leasing costs for larger, more modern facilities may be higher, but operations are so much more efficient that the higher levels of rent pay for themselves.”

For years now, interest rate levels in Japan have been extremely low. This brings about a significant multiplier effect caused by the limited use of amounts of debt with investments. This means that attractive yields can be attained. Nevertheless, there are limits to the leverage that

can be used. “In the Netherlands, Bouwinvest applies the principle that financing (leverage) is precluded and only used to a limited extent internationally. On average, leverage internationally should be no more than 50%, but more often than not, we don’t go above 40%.”

### Project Tokyo

Bouwinvest, in partnership with other institutional investors, recently made a significant investment in offices in central Tokyo, in anticipation of an upturn in the market. For a long time now, the office market has been in a dip, which has meant that the availability of new offices has been on the wane. “The consensus is that the market has reached its nadir and that it will start to recover. We are responding to the cycle in the market by acting now. We anticipate that rent levels will drop slightly to start with before they start increasing again. By getting out at the right moment, that is, at a point higher in the market cycle, an attractive yield can be attained with the offices responsible for generating this direct income, which – in combination with leverage - can amount to as much as (and more than) 10%.”

De Grunt emphasises the fact that the investments do not involve large and prestigious office buildings such as available in the Zuidas in Amsterdam, but smaller, high calibre office spaces. “Tokyo has a lot of small to medium-sized companies that aren’t looking around for large office space, but something smaller on a single floor. These offices have all been built in line with the latest seismic code regulations and suffered next to no damage during the major earthquake of March 2011. Businesses located in less-well protected offices took fright and decided to move into quake-proof offices. We are heartened by the fact that disasters like this are having a limited impact on our investment.”

The office market in the centre of Tokyo is quite different to that in other world metropolises. According to De Grunt, this is a legacy of the Second World War in which all major cities, including Tokyo, were bombed flat. “When Tokyo

was rebuilt, use was made of the original street grid with the result that plots of land were small and cramped. To develop large office complexes, project developers have to buy adjacent allotments in piecemeal fashion in order to get a decent sized plot of land. It’s an extremely complicated and costly procedure and requires the patience of Job.”

The result is a plethora of sliver-like office blocks, 4, 5 or 6 floors in height with an extremely limited amount of floor space. “This is the type of office we are prioritising. These are top-quality locations with reliable tenants. They generate a stable cash flow: two-thirds of the yield of 10% is direct yield and, for the remaining third, an improvement in the market is anticipated. This means you can realise an additional plus. You would not call it sexy, but more often than not a prestigious building – by reputation alone - does not necessarily represent a good investment. It is crucial to understand how the market is likely to develop, to accept that the rent might drop to start with, and not to panic.”

‘The attraction lies not in size or prestige, but in the specific investment’

### Culture

Anyone doing business in Japan will come into contact with Japanese culture and it is important that Westerners know how to deal with it. The language is an obstacle, even though younger generations know some English, and the cultural differences are huge. “Japanese society is very much inward-looking”, de Grunt concludes. “I once had a meeting with 15 people on the other side of the table. Opposite me was the CEO who spoke no English at all. All he did was reading a statement in Japanese, which was translated by his assistant. Communication therefore took place via the assistant. Language is a real barrier. After all, you’d rather not do business with partners who

### TOKYO OFFICE

Recently, Bouwinvest has been investing in a Tokyo Office real estate fund. The investment strategy targets the acquisition of offices in the centre of Tokyo, in the Chuo, Minato, Chiyoda, Shibuya and Shinjuku districts.

Two objects were recently added to the portfolio, namely:

- 1 Meguro Place Tower in Meguro Ward, with an investment totalling approx. EUR 40 million – 3,500 m<sup>2</sup> of floor space divided over 14 floors with a 100% lease;
- 2 Glass City Shibuya in Shibuya Ward, with an investment totalling approx. EUR 110 million – 8,600 m<sup>2</sup> of floor space divided over 11 floors with a 100% lease;

Both objects meet the latest seismic building codes and are recent constructions (up to 15 years old). The offices are characterised by a steady rate of earnings from rent.



don't speak any English. Nevertheless, I'm convinced that it's not possible to do business successfully here without involving a Japanese partner. We make our logistics investments together with an international manager who himself took over a Japanese company. The company has an international label, but apart from the CEO and COO, it's a Japanese company through and through."

‘Doing business successfully is impossible without involving a Japanese partner’

#### Portfolio

Although Bouwinvest invests in housing worldwide, this is extremely limited in Japan. This is a problem of economies of scale. "It's difficult to create enough volume to make investment attractive for us and to spread the risks. Land prices are just extremely high in Tokyo. Standard mid-range rented accommodation consists of 30-35 square metres, which is nothing more than a studio with a tiny bathroom. Yields on such investments are quite good, around 10%, with stable levels of direct income. But volume is what is needed. If we invest, this means amounts of at least 25 million euros. If you start doing that with 10 to 20 dwellings per year, the costs of building up the portfolio are too high to be attractive. The solution is to enter into sizeable portfolios which already exist, but these are few and far between in the market."

However, a future investment strategy concentrating on elderly housing is being looked into, given that Japan has a rapidly ageing population. The focus will be on a combination of housing and care. "Residents have their own small room with a bed and a chair, a bathroom in the hallway with its own toilet, washbasin and shower, and a communal area. These housing concepts are extremely popular in Japan, because the elderly

can no longer live with their children because they both go out to work." The strategy still has to be fleshed out, but the underlying demographics are irreversible. Another part of the solution to the ageing issue lies in more efficient working methods. "Japan is a country that can benefit tremendously from more efficient ways of working and so help solve some of the problems associated with the ageing population, but not completely. It means that Japan will have to allow more outsiders into the country in the future. At the moment, Japan has absolutely no experience with this. Any inward migration will bring with it a new set of dynamics and a growing economy will mean that incomers will need offices and housing."

As far as future investment is concerned, Bouwinvest is primarily looking at the office market in Tokyo, modern distribution centres, in particular in Tokyo and Osaka, and over the longer term, elderly housing and the residential market in Tokyo.

#### Active portfolio management

In principle, investment in Japan is focused on the long term. De Grunt believes that it is a market, which will have to be actively managed given the macro-economic and demographic developments at play there. In his view, the Japanese market needs constant monitoring to see whether it holds sufficient attraction. "Certainly, investment in the office market in Tokyo is tied in with market cycles, which automatically means there's also an exit strategy in place. As professional investors, it's our duty to monitor the situation and shift our investments if and when the time arrives. The maturity of the market means that Japan will remain included in the Asian portfolio."

For us, the attraction of Japan lies in the fact that it's one of the few markets in Asia where it's possible to generate direct yield and where you're not just anticipating future sales. In many growth markets, project development is the driving force, but that has completely different characteristics. Japan is also attracting pension funds because it offers a steady cash flow, which is highly valued."

To develop large office complexes, project developers have to buy adjacent allotments in piecemeal fashion in order to get a decent sized plot of land. It's an extremely complicated and costly procedure and requires the patience of Job." The result is a plethora of sliver-like office blocks, 4, 5 or 6 floors in height with an extremely limited amount of floor space. "This is the type of office we are prioritising. These are top-quality locations with reliable tenants."





# Not even a cup of coffee

**'Wimp', my friend Klaas said accusingly, just before he got into his car to visit a new customer in Germany. At least he wasn't showing any fear of making any gaffes during negotiations, adding, "but if only the language didn't have all those datives and genitives.'**

Annette Birschel, Journalist, writer

"Forget about the cases", I said, "you'd be better off polishing your shoes". He looked at me as if I'd suggested that Arjen Robben should solve the euro crisis.

Of course, Klaas was perfectly right. Doing business with neighbours shouldn't be that difficult. After all, the Dutch and the Germans have a lot in common. Nevertheless, it's the deceptively subtle differences in culture that make the border such a yawning gulf and confirm all the stereotypes: Germans are strait-laced and formal, while the Dutch are offhand and superficial.

## Shoes

You can tell by the shoes. Germans like sturdy, orthopedically sound shoes that enable them to take purposeful strides forward and provide them with the sense of security they crave. And what does a Dutch person wear? Sneakers: loose-fitting shoes that are comfortable to wear anytime, anyplace. The Germans and the Dutch have a different place in the world. The one places safety über alles, the other comfort and convenience.

I wanted to explain to Klaas that academic titles, neckties and the formal second person Sie were simply a sign that Alles ist in Ordnung.

Never mind. It started to go wrong the moment Klaas walked into the offices of his German business partner and cheerfully said, "Sorry, I'm a bit late, but I had to take the kids to the crèche." The German, Herr Doktor Meyer-Wiedenhöfer, was somewhat taken aback by this unsolicited glimpse into Klaas' personal life. For a German, work and private life are two totally separate things. Uneasily, he started flicking through a file replete with risk analyses.

With the conversation ignoring any personal niceties, Klaas began to feel uncomfortable. It was straight down to business, without the slightest hint of a cup of coffee. If Germans only knew the significance of a cup of coffee to Dutch business, trade between Germany and the Netherlands would suddenly increase by 30 percent. A cup of coffee just makes things so much more congenial. Congeniality, however, wasn't Herr Doktor Meyer-Wiedenhöfer's strongest point. He looked at Klaas with a distrustful eye as if to say, "Is it really possible for someone who only has a first name to take important decisions?"

In the end, it all worked out well between the two. A few weeks later, after the contract had been signed in the Netherlands, a plate of bitterballen was produced. Herr Doktor Meyer-Wiedenhöfer loosened his tie, gave Klaas his hand and with a sigh of relief said, "Oh, by the way, my name is Horst."

# risk

# 3X

## Risk, compliance and internal audit

In the past few years, developments in the financial world have led to increasing calls for tighter statutory regulations. The banking sector was the first to be subjected to more stringent regulatory controls with the Basel convention. But that was only the start. Other sectors have also been tarnished by accounting scandals and fraud, which has led to greater financial regulation, such as Sarbanes Oxley and the Tabaksblat corporate governance code. More and more importance is being attached to internal risk control, compliance, transparency and accountability to stakeholders.



# In control in real estate

After a major case of fraud in the real estate sector in the Netherlands, a shift in attitude has taken place. Apart from stricter control and stakeholders who are forcing the sector to accept measures, many organisations are coming to realise that such practices are really no longer acceptable. Partly in the wake of new regulatory measures and the need to clean up the profession, serious attention is now being focused on risk management, compliance and internal audit.

## European directive

One of the most important developments affecting Bouwinvest is the changing nature of the regulatory controls, which will have a major impact on risk management, compliance and internal audit. Up until now, Bouwinvest has not been subject to the licensing obligation on the basis of current legislation. However, this will all change in 2013 with the introduction of the new European directive for alternative investment funds, the Alternative Investment Fund Managers Directive (AIFMD). As a result of this directive, which will be incorporated into Dutch legislation by July 2013, Bouwinvest is required to apply for a licence from the Authority for Financial Markets (AFM). The AIFMD directive imposes a number of requirements on the organisation, but will also have an important effect on risk management, compliance and internal auditing activities.

In anticipation of the directive, Bouwinvest has been busily laying the groundwork prior to its implementation since 2011. For the greater part, this is now all in place. The directive contains a

number of requirements that real estate asset managers must satisfy, such as appointing an independent custodian to act as a kind of intermediary between Bouwinvest (as manager), the investor and the regulator. According to the directive, this custodian is responsible for verifying ownership, carrying out checks with the chamber of commerce and the land registry, and monitoring significant cash flows. The custodian represents an additional, new form of regulation, but whose tasks and responsibilities still need to be properly fleshed out. In addition, there are a number of other requirements that Bouwinvest must satisfy.

Supervision by the AFM adds a new dimension to real estate investment management, but it is not anticipated that this will lead to any major problems. Likewise, in respect of the other requirements of the directive, Bouwinvest is well prepared.

## Professionalising risk management

Due to the changing requirements with respect to financial legislation, Bouwinvest – which has had a

risk management function since 2008 – has committed itself to professionalising its risk management activities. To this end, it has adopted the internationally recognised COSO framework as a model for risk management. This model not only focuses on internal control, but on the entire internal control system. Its full name is ‘COSO II of Enterprise Risk Management Framework (ERMF)’. It is on the basis of this framework that Bouwinvest has set up its own Responsibility and Monitoring Framework with the so-called ‘four lines of defence’. In this context, management, supporting risk, compliance and control functions, internal auditing and the supervisory board each have their own monitoring role in the organisation’s risk control process.

As part of Bouwinvest’s risk management procedure, the objectives, processes and the related risks are examined from the organisation’s own perspective. Once the objectives and the risks have been identified, closer consideration is given to possible mitigating measures that can be taken to manage these risks. Annual plans are then drawn up and checks made as to whether these plans are compliant and the risks associated with these plans. Among other things, the objectives set down in the annual plans are translated into quarterly risk reports so that the risks can be monitored.

## Investment Committee

The Investment Committee has a key advisory role vis-à-vis the management board in the context of risk management. The Senior Risk Manager and Senior Compliance Officer are both represented in this body and are responsible for evaluating the investment process, the decision-making procedure and investment proposals. Prior to the investment the proposal is validated in respect of the requirements set as part of the investment plan. This examines whether the investments are within the budgeted amounts for the different locations and whether the risk classification fits in with the portfolio’s diversification programme and

whether it concerns core, added-value or opportunistic investments.

Once the IC has given its recommendations, the proposal is submitted to the management board for a final decision and, if the investment exceeds a specific amount, the proposal is also submitted to the supervisory board.

Working with leverage is a well-known and high-risk factor in the real estate sector. The use of leverage raises the prospect of risk and volatility and is thus a key factor in the investment industry. Currently, the weighted leverage of the overall real estate portfolio of bpfBOUW is 12%, compared to the maximum permissible rate of 15%. The Dutch component of the real estate portfolio does not include any leverage. International real estate investments are permitted to have average weighted leverage levels up to a maximum of 50%.

‘AFM supervision adds an extra dimension to real estate investment management’

## Internal audit

In addition to compliance and risk, internal audit activities at Bouwinvest provide management with additional security by giving an objective and independent judgement on the quality and effectiveness of how governance, risk management and control systems operate.

Although there is a solid ERMF, it will be important in coming years to continue to maintain this and to re-evaluate on the basis of new developments. Partly as a result of collaboration in the area of risk, compliance, control and the business, it is possible to sustain an organisation that remains in control and meets the interest of all its stakeholders.

Check on page 18 how Bouwinvest has organised its ‘lines of defence’.



**1** When Marijke van Kamp was appointed Compliance Officer at Bouwinvest three and a half years ago, the compliance function still had to be set up. In the meantime, the organisation has a much better understanding of why functions such as compliance, risk and internal audit are needed. Compliance is a specific discipline that examines whether statutory regulations have been implemented and if these are being complied with by the organisation. It facilitates the organisation to carry out its work effectively.

At the beginning, everyone was inconvenienced by having to account for themselves, but more and more, according to Marijke, people are accepting that compliance, with respect to anything relating to investment, must be implemented as a matter of course. “Everyone is aware of the rules we agreed on. Every time an investment proposal is made, the question is automatically posed: have you called in compliance and has a screening of the business partner been conducted?”

#### Identifying problems beforehand

Every investment is screened by the Investment Committee beforehand, especially with respect to risk and compliance, and any possible problems identified in advance. “At that point, there is still time to fine-tune the proposal. The final document, on the basis of which decisions are taken, must at least satisfy the statutory regulations.”

#### New regulator

A lot of water has passed under the bridge at Bouwinvest since 2008 when it comes to compliance and the statutory regulations that must be met. “Up until now, as real estate investment manager for the bpfBOUW pension

fund, only De Nederlandsche Bank has acted as regulator. Things will change as of 22 July 2013, when the new European Directive for alternative investment funds, the AIFMD (Alternative Investment Funds Managers Directive) will come into effect as part of the Financial Supervision Act (Wft) and, as such, will apply to Bouwinvest. We also have to deal with the Authority for Financial Markets (AFM), which is to become our regulator.”

In anticipation of the AIFMD directive, Bouwinvest has been busy since 2011 with the implementation of this legislation. As AIFMD project coordinator, Marijke is responsible for implementation of the directive within the organisation. Compliance ensures implementation and licence applications with the AFM. She believes it is important not only for the organisation to know the rules, but also to apply them as well.

‘Knowing the rules is one thing, applying them is another’

#### Stakeholders

Not only is the new legislation responsible for bringing about different dynamics in the organisation, also the chosen strategy, used for allowing outsiders to invest in the funds, has resulted in different stakeholders. “It is now our aim to allow newcomers to the funds and that has become our core business. The focus has since been fully directed towards fund management and International Investments. That means a completely new playing field when it comes to regulation, both internally and externally, and a completely different means of reporting. It adds a different dimension and brings about a different kind of organisation.”

Marijke van Kamp, Senior Compliance Officer at Bouwinvest REIM. Since 2009, Marijke van Kamp has worked at Bouwinvest REIM as Compliance

Officer. In the last few years, Marijke has been mainly involved in the implementation of new statutory regulations in the framework of the

European Directive for alternative investment funds, AIFMD. Before working for Bouwinvest, she worked at State Street Bank and Atos Consulting.





**Peter van Egmond, Internal Auditor Bouwinvest** Peter van Egmond has been working for Bouwinvest since 2004. After completing his accountancy

training at Ernst & Young, he started working for Bouwinvest as the Financial Administration Manager. Later he was appointed to the position

of Reporting Manager and is now an Internal Auditor, involved in auditing the organisation so that it remains in control.

**2** “The main role of internal audit is to take a close look at the organisation to establish whether all risks have been identified and the control measures relating to these have been correctly implemented, so that the organisation can say: we are in control. To achieve this, risk assessment and control awareness are required in the organisation. We have to ask ourselves: are all the risks we have identified properly under control?”

#### Creating consensus

Furthermore, according to Peter van Egmond, Internal Auditor at Bouwinvest, it is important to have assessment, control and advisory processes in place to help improve the organisation. “As a controller, this means you can keep track of unforeseen relationships within the organisation and identify risks that coincide with each other. It is important to create consensus in the organisation, so that people are not afraid to come to us.”

The biggest risks within the organisation are associated with acquisition, disposition and valuation of the investments in assets. At Bouwinvest, an all-round approach to these risks has been adopted. “All acquisitions are screened beforehand by the Investment Committee, which also checks whether the investment fits in with the profile of the investment plan that has been agreed with the client.”

#### Monitoring

Several individuals and departments are also involved with dispositions. “In addition to the business, the various staff departments have their own role in risk management. In the case of disposition, we examine how the object has performed in terms of value over the recent quarters. If there is a hiccup at any point, several

persons will take a closer look at what might have gone wrong. We monitor every sale for at least a year to make sure it is not an ABC delivery.”

#### Valuation

Another high-risk activity is the valuation of real estate. In Peter’s opinion, as long as the underlying control measures have been carried out properly, it is an acceptable risk. He emphasises that the entire valuation process is tracked. “We have our own valuation management system, which involves all properties being valued externally every quarter. The surveyors receive data from our system four times a year. We complete a number of parameters for them and they can then add their own findings. The eventual value is then discussed with our asset and portfolio managers and is fixed as the new value for that particular quarter. Two days later, a start is made on the

‘Do we have effective control of all the risks we have identified?’

valuation for the next quarter. In fact, it is an on-going procedure, with surveyors being shifted around every three years.”

Risks are all part of business, but procedures and protocols, set down in the form of control measures, ensure that we can manage the risks adequately and that the residual risk is acceptable. Following the establishment of the Investment Committee, the existing protocols and all control measures that have been drawn up as part of the ISAE 3402 project, Peter is convinced that the risks are properly identified. “If everyone carries out the control measures properly, the risks are manageable.”





**3 Risk, compliance, audit and control are not departments to be considered in isolation. Close cooperation with each other and with the business is essential. The world around us is changing, so for risk management it is appropriate to translate these changes into processes, risk assessment and control measures in a timely fashion.**

#### Integrated risk management

Marianne Zonneveld has been responsible for risk management at Bouwinvest since July 2012. When she arrived, Marianne found an organisation that had set down its risk management processes effectively on paper and was implementing these in generalised form, but there was little evidence of compartmentalisation. She sees her task as bringing risk management, compliance, audit and the business together, so that the next step can be taken in creating a fully fledged, integrated risk management system.

#### Integrity tests

Marianne believes that management needs to acquire integrated responsibility from the business for managing risks. "In an ideal situation, risk management will be fully integrated into the organisation. My job is to proactively facilitate this process and generate awareness in the business. It is all a question of talking to people, explaining things and making clear that it can also be of benefit to the business. After all, if newspapers are reporting about new government measures, you should start to ask yourself what this might mean for the business. I try to get the discussion going about these things."

According to Marianne, the biggest challenge facing the implementation of effective risk management is the human factor. "HRM has to play a key role in this. It all starts with a good recruitment policy, with

integrity tests and we have a code of conduct in place that applies to everyone. We use risk-culture profiles with which we assess individuals on the basis of their motivation. These profiles enable us to get a better picture of whether or how these individuals can contribute to a department's objective."

As risk manager, Marianne sits on the Investment Committee, on which various disciplines are represented who come together to discuss potential investments and test them against the investment beliefs of Bouwinvest. "The Investment Committee is comprised of professional and committed staff members. The discussions are engaging and issues examined critically. It has since become part of the organisational culture for critical questions to be asked to each other and relationships and links scrutinised."

#### Balancing act

**'In an ideal situation, risk management would be fully integrated into the organisation.'**

Not only are internal discussions becoming more probing, other stakeholders are asking more and more questions, too. So, from a risk management point of view, it is important to keep watch over the interest of all stakeholders. "It is a fine balancing act. You have to have a keen awareness of stakeholder interests and organise your controls and communication around these. Since I arrived, there has been intensive cooperation between the Risk, Compliance, Corporate Control and Audit departments to ensure that everyone is singing from the same hymn sheet when it comes to external communications."

Marianne Zonneveld, Senior Risk Manager at Bouwinvest. As Senior Risk Manager since July 2012, Marianne Zonneveld is responsible

for Bouwinvest's risk management. She can fall back on broad experience in the field of risk and compliance after working at various financial

institutions, including Aegon and Zwitserleven. She was active in various executive, management and policy roles within these organisations.





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