

# Lowe Enterprises Loses Major Client

## Key Points

- The Pennsylvania State Employees Retirement System (PA SERS) has ended its relationship with Lowe Enterprises Investors (LEI).
- PA SERS investments accounted for more than 70 percent of LEI's public pension fund AUM and 37 percent of LEI's total AUM.
- The returns LEI achieved on behalf of PA SERS have in recent years underperformed the yields offered by Treasury securities.
- During the same period, PA SERS other separate account managers have outperformed LEI by substantial margins.
- As LEI acknowledges that it faces a potential conflict of interest in determining how to allocate investment opportunities, limited partners may inquire into how assets have been allocated through the firm's rotation system.

Low Enterprises Investors (LEI) is an investment affiliate of Lowe, a Los Angeles-based real estate firm, and the Guardian Life Insurance Company of America.<sup>1</sup> As of December 31, 2017, LEI had more than \$3.1 billion in assets under management, all on a non-discretionary basis, through fifteen separate accounts.<sup>2</sup>

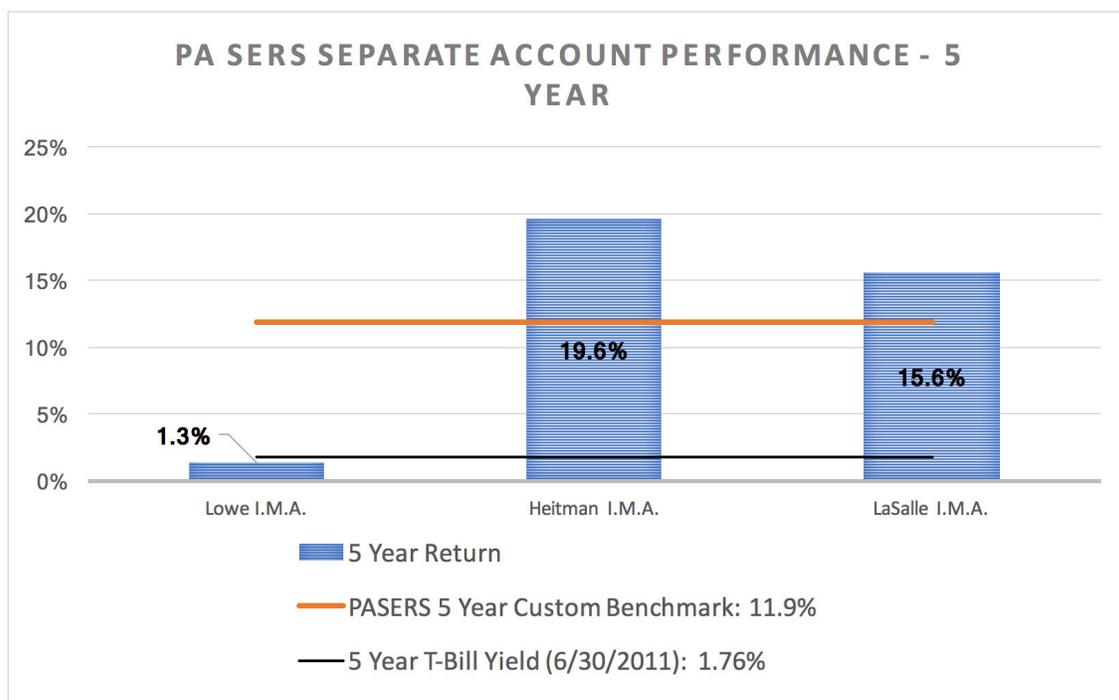
In April 2018, the Pennsylvania State Employees' Retirement System (PA SERS) announced that it would end its long-term relationship with LEI.<sup>3</sup> PA SERS was among LEI's larger institutional clients. The investment relationship dated to 1994, and as of early 2018 PA SERS maintained two separate accounts with LEI worth a combined \$1.2 billion.<sup>4</sup> These PA SERS investments accounted for 37 percent of LEI's total assets under management [AUM] and more than 70 percent of LEI's public pension fund AUM.<sup>5</sup>

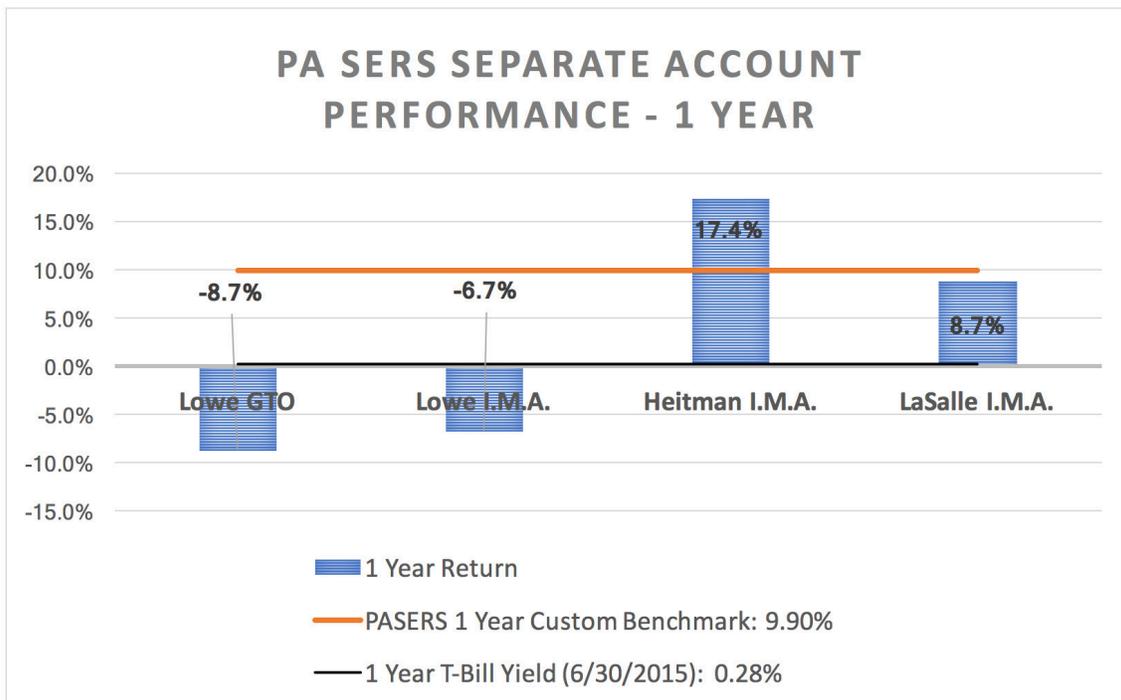
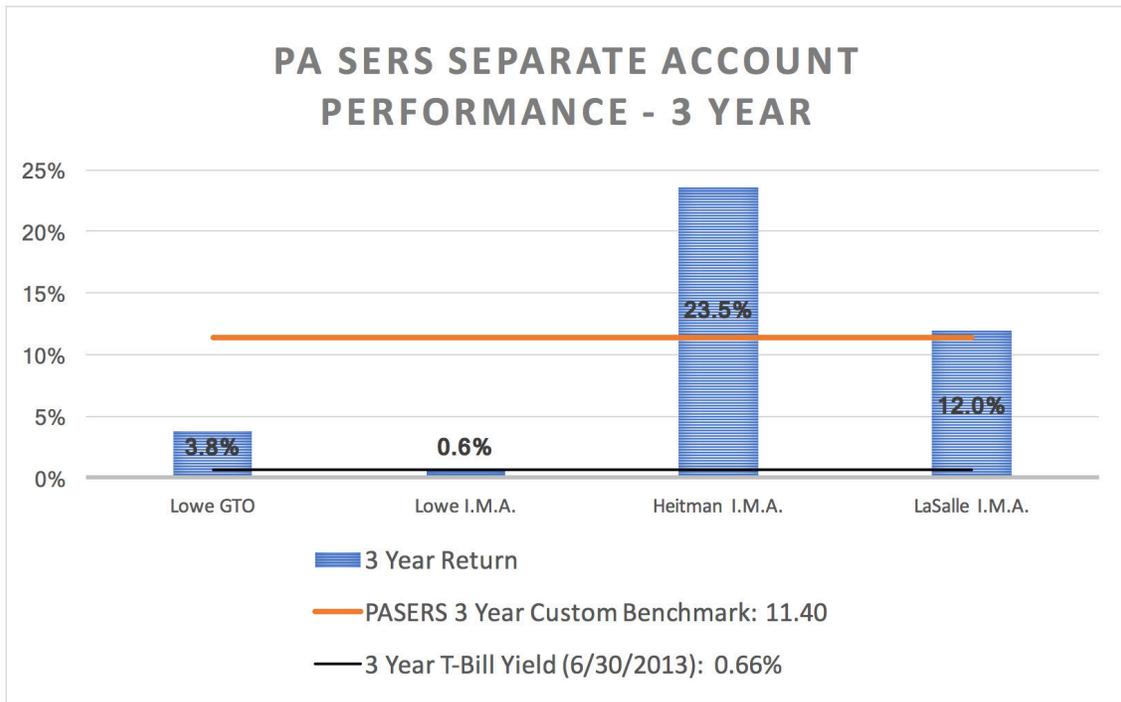
## Lower Returns than Treasuries

LEI most recently managed two separate accounts on behalf of PA SERS, Lowe IMA, which was established in 1994, and Lowe GTO, which dated to 2012.<sup>6</sup> For the year ended December 31, 2016,

the returns generated by Lowe IMA and GTO lagged far behind those achieved by PA SERS's other two real estate separate accounts, Heitman IMA and LaSalle IMA, both of which have core mandates. Lowe IMA and GTO also failed to meet the fund's custom real estate benchmark over those same periods, whereas both Heitman and LaSalle beat the retirement fund's custom benchmark over the three- and five-year periods.<sup>7</sup>

It is noteworthy is that Lowe IMA and GTO also underperformed the rates on offer by Treasury securities.<sup>8</sup> As seen in the charts below, as of Dec. 31, 2016, Lowe IMA had achieved a five-year return of 1.3%. In mid-2011, a five-year Treasury note, maturing in mid-2016, offered a yield of 1.76%. The yield on a three-year Treasury note in mid-2013 of 0.66% too would have outperformed Lowe IMA's Dec. 31, 2016 three-year return of 0.6%. And Lowe IMA and GTO's strong negative returns over the one-year period would have fallen short of the 0.28% yield a one-year Treasury note carried in mid-2015.





The past decade has been a period of historically low interest rates and, from the nadir of 2008-09, of galloping commercial real estate valuations. Even in such a favorable real estate investment climate, Lowe could have earned higher overall returns on behalf of PA SERS by investing in Treasury bonds, the lowest-risk securities the market has to offer, than the company was able to achieve through its real estate investments.

## Conflicts of Interest

LEI acknowledges that a conflict of interest could exist because “we manage accounts for clients who may have agreed to pay us different kinds and/or rates of fees” and therefore “we may have an incentive to favor accounts for which we receive greater fees by recommending real estate related investments to clients to pay us higher fees over clients who pay us lower fees.”<sup>9</sup>

The firm notes that they address this conflict through application of a rotation system, which allocates those assets which more than one client may have an interest on a sequential basis. LEI assures investors that a record of assets allocated through this rotation system will be made available annually to all clients upon request.<sup>10</sup>

In addition to public pension funds, LEI clients include corporations and major insurance companies.<sup>11</sup> LEI currently manages \$1.2 billion on behalf of corporate investors.<sup>12</sup> Moreover, the Guardian Life Insurance Company of America is both a client and an owner of LEI. In 2010, when Guardian Life acquired a “substantial interest” in LEI, the insurance company also committed more than \$200 million “to co-invest in activities where Lowe invests its own capital and to invest alongside Lowe’s clients and partners.”<sup>13</sup>

Guardian Life is a co-General Partner of LEI and has had an account actively managed by LEI executives. Current and prospective LEI limited partners should have the right to know how investment opportunities are being allocated between Guardian Life, other insurance companies that are LEI clients, and LEI’s public pensions fund clients.

Given the abysmal rate of return LEI has achieved on behalf of PA SERS, all public pension limited partners should take steps to ensure their capital commitments are receiving the priority they deserve.

## Key Questions for Investors

- What factors account for LEI’s underperformance in the PA SERS separate accounts, and should the contributing factors draw concern from other current and prospective investors?
- To what extent have the potential conflicts of interest LEI has acknowledged contributed to the firm’s poor management of PA SERS assets?
- What steps can limited partners take to ensure that investment opportunities are being allocated in a fair manner?
- Is LEI fit to manage your investments?

## Endnotes

- 1 The full legal name of Lowe Enterprises Investors is Lowe Enterprises Investment Management LLC. See Lowe Enterprises Investors SEC Form ADV (4/4/2018). The parent entities of Lowe Enterprises Investors LLC are LEIM Parent, Inc. a wholly-owned subsidiary of Lowe Enterprises, Inc. and Guardian LEIM, LLC, a wholly-owned subsidiary of the Guardian Life Insurance Company of America. As of March 1, 2013, Guardian Life reported to the SEC that it owned 50% of Lowe Enterprises Investment Management, LLC. In 2010, a Lowe spokesperson was quoted in the *Wall Street Journal* asserting that Guardian Life had acquired “slightly under 50%” of Lowe Enterprises’ investment-management arm. See Lowe Enterprises Investors, Form ADV, Part 2A (March 28, 2018), p. 1 [hereafter “LEI 2018Q1 ADV Brochure”]; SEC Form N-6 for Guardian Separate Account N – Flexible Solutions VUL III, Item 29; Kris Hudson, “Guardian Life, Lowe Team Up,” *Wall Street Journal*, July 7, 2010.
- 2 LEI 2018Q1 ADV Brochure, p. 2; Lowe Enterprises Investors, SEC Form ADV (4/4/2018), Item 5.
- 3 Jon Peterson, “Pennsylvania SERS Replaces Real Estate Managers on Separate Accounts [corrected],” *IPE Real Assets*, April 30, 2018, accessed at: <https://realassets.ipe.com/news/pennsylvania-sers-replaces-real-estate-managers-on-24bn-of-separate-accounts/10024424.article>.
- 4 Peterson, “Pennsylvania SERS Replaces Real Estate Managers.”
- 5 LEI managed two PA SERS separate accounts with a combined value of \$1.2 billion. As of its most recent SEC filing, LEI had \$3,174,934,210 in total AUM. Of that amount, \$1,660,031,847 came from “State or municipal government entities (including government pension plans). PA SERS’s two separate accounts with LEI were worth a combined \$1.2 billion. See LEI 2018Q1 ADV Brochure, p. 2; Lowe Enterprises Investors, SEC Form ADV (4/4/2018), Item 5; Peterson, “Pennsylvania SERS Replaces Real Estate Managers,” *IPE Real Estate*, April 30, 2018.
- 6 PASERS, 2016 Comprehensive Annual Financial Report, p. 68.
- 7 Unless otherwise noted, all PA SERS returns data are as of Dec. 31, 2016. They were obtained through a Right-to-Know request [RTK]. Returns were calculated using a time-weighted return methodology. The PA SERS custom benchmark consists of the NCREIF-ODCE Index, the S&P Developed Property Market Index, and the Consumer Price Index. See PA SERS, 2016 CAFR, p. 44.

	1-year	3-year	5-year
<b>Lowe GTO</b>	-8.7%	3.8%	N/A (five-year data for GTO are not yet available)
<b>Lowe IMA</b>	-6.7%	0.6%	1.3%
<b>Heitman IMA</b>	17.4%	23.5%	19.6%
<b>LaSalle IMA</b>	8.7%	12.0%	15.6%
<b>PA SERS Custom Benchmark</b>	9.9%	11.4%	11.9%
<b>Treasury Notes</b>	0.28% (1-year T-Bill yield, 6/30/2015)	0.66% (3-year T-Bill yield, 6/28/2013)	1.76% (5-year T-Bill yield, 6/30/2011)

- 8 RTK. For daily Treasury yield curve rates, see <https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield>.
- 9 LEI 2018Q1 ADV Brochure, p. 3.
- 10 Ibid.
- 11 In addition to the Guardian Life Insurance Company of America, Lowe has had investment relationships with Allstate Insurance and Northwest Mutual. See <http://laserweb.redondo.org/WebLink/0/edoc/227908/E.%20Lowe%20Enterprises%20-%20RFV%20Submittal.pdf>, p. 38-39.
- 12 Lowe Enterprises Investors, SEC Form ADV (4/4/2018), Item 5.
- 13 <http://laserweb.redondo.org/WebLink/0/edoc/227908/E.%20Lowe%20Enterprises%20-%20RFV%20Submittal.pdf>, p. 38.