

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4726 / July 6, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-18060

In the Matter of

**PARAMOUNT GROUP REAL
ESTATE ADVISOR LLC,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e) AND
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Paramount Group Real Estate Advisor LLC (“Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

SUMMARY

1. This matter concerns Paramount Group Real Estate Advisor LLC's conduct with respect to a transaction between two private funds it advised. In March 2014, Respondent, a registered investment adviser, caused Paramount Group Real Estate Fund III, L.P. ("Fund III") to sell one of its investments in real property, a parking garage, to Paramount Group Residential Development Fund, L.P. ("RDF"). In connection with the transaction, Respondent failed to cause RDF to reimburse Fund III for certain development expenses Fund III had incurred before the sale, despite Respondent's commitment to Fund III's investor advisory committee ("Fund III IAC") at the time the Fund III IAC approved the sale that the reimbursement would be made. Specifically, Respondent failed to seek approval from the Fund III IAC, or the Fund III Limited Partners, to eliminate the reimbursement requirement as a condition of the sale, and failed to disclose its decision to the Fund III IAC or the Fund III Limited Partners that no such reimbursement would be made. At the time of the sale, Respondent served as investment adviser to both Fund III and RDF, of which Respondent and its affiliates owned 3% and 26.7%, respectively. Based on the foregoing conduct, Respondent violated Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder.

RESPONDENT

2. **Paramount Group Real Estate Advisor LLC** is a Delaware limited liability company with its principal place of business in New York, New York. It is an investment adviser registered with the Commission since March 2012. Respondent provides discretionary investment advisory services for private real estate investment funds that invest in real property and real estate related securities. As of March 29, 2017, Respondent had approximately \$2.03 billion in reported regulatory assets under management. Respondent's corporate parent is Paramount Group, Inc.

RELEVANT ENTITIES

3. **Paramount Group Real Estate Fund III, L.P.** is a Delaware limited partnership and real estate investment fund formed in 2005. During all times relevant to the findings herein, Respondent served as investment adviser to Fund III, and Paramount GREF III, L.L.C. ("Fund III GP"), a Delaware limited liability company and an affiliate of Respondent, served as its general partner.

4. **Paramount Group Residential Development Fund, L.P.** is a Delaware limited partnership and real estate investment fund formed in 2013. During all times relevant to the findings herein, Respondent served as investment adviser to RDF, and Paramount GREF RDF,

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

LLC, a Delaware limited liability company and an affiliate of Respondent, served as its general partner.

FACTS

A. Background

5. The investors in Fund III (each, a “Fund III Limited Partner” and collectively the “Fund III Limited Partners”) committed to contribute a specific amount of capital to Fund III for the purpose of investing in real estate. Investments in Fund III (in the form of limited partnership interests) were primarily governed by four documents: a Private Placement Memorandum, a Limited Partnership Agreement, an Asset Management Agreement, and an Investment Advisory Agreement (collectively, the “Organizational Documents”).

6. The Organizational Documents required Fund III to establish the Fund III IAC consisting of a subset of Fund III Limited Partners. The Fund III IAC had the authority to (a) “review any potential conflicts of interest in any transaction or relationship” between Fund III and Fund III GP, or any other Respondent affiliate; and (b) review any matter for which approval is required under the Advisers Act.

B. Respondent Caused Fund III to Sell the Garage to RDF

7. Fund III owned a San Francisco office tower and garage. Respondent determined the garage portion of the property, which Fund III held through a special purpose vehicle, would be more valuable as a separate residential development. However, the property was not yet zoned for the proposed size of the residential tower; Fund III was past its investment period; Fund III did not have sufficient capital to fund a long-term development project; and a residential property was outside Fund III’s investment mandate.

8. On July 2, 2013, Respondent held a meeting of the Fund III IAC to obtain approval to sell Fund III’s investment in the garage to RDF, which was formed for purposes of purchasing and developing the property. Respondent explained that independent appraisers would determine the sales price and projected the garage could be valued between \$45 million and the low-\$50 million range. Respondent disclosed that RDF was an affiliated fund and offered the Fund III Limited Partners the right to invest in RDF. In response to a question from a Fund III Limited Partner, Respondent informed the Fund III IAC that Fund III would be reimbursed for development expenses it had incurred in an effort to get the property upzoned ahead of the sale. At the time, such expenses totaled \$3.5 million; by the time of the sale, they totaled \$4.5 million. The Fund III IAC approved the sale of Fund III’s investment in the garage to RDF for no less than \$45 million and on the condition that Fund III be reimbursed for the incurred developmental expenses.

9. The garage served as collateral for loans against the entire property and Fund III’s lenders required it be sold for no less than the average of the highest two of three independent appraisals. The independent appraisals Respondent obtained valued the garage at \$49 million, \$56 million, and \$73.1 million. Unlike the two lower appraisals, which valued the garage as currently

zoned, the \$73.1 million appraisal was premised on the garage's ability to obtain the beneficial zoning changes.

10. Following the appraisal process, Respondent decided not to cause RDF to reimburse Fund III for the development expenses Fund III incurred in an effort to get the garage upzoned before the sale. In Respondent's view, the final price RDF paid to Fund III already reflected the increased value that would result from the upzoning, and related expenses, because one of the two appraisals ultimately used to calculate the purchase price effectively assumed the upzoning would be achieved.

11. On March 14, 2014, based on the average of the two highest independent appraisals, Respondent caused Fund III to sell its investment in the garage to RDF for \$64.65 million. At the time of the sale, Respondent and its affiliates collectively owned 3% of Fund III and 26.7% of RDF.

12. However, Respondent failed to seek approval from the Fund III IAC or the Fund III Limited Partners to eliminate the reimbursement requirement as a condition of the sale of the garage to RDF, or to disclose to them, at the time, its decision not to cause RDF to make the reimbursement despite its commitment to do so.² Respondent had a conflict of interest because it owed a fiduciary duty to both sides of the transaction and because it (or entities affiliated with it), at the time, owned a larger percentage share of RDF than of Fund III. Consequently, Respondent could not effectively consent on behalf of Fund III or the Fund III Limited Partners to eliminate the reimbursement requirement upon which the Fund III IAC expressly conditioned its approval of the sale of the garage.

C. 2015 OCIE Examination and Respondent's Remediation

13. In July 2015, staff of the Commission's Office of Compliance Inspections and Examination ("OCIE") conducted an examination of Respondent and raised concerns about Respondent's failure to cause RDF to reimburse Fund III for the garage development expenses.

14. On August 19, 2015, after the OCIE examination findings and further discussion with OCIE and Division of Enforcement staff, CNBB-RDF Holdings, LP, an entity owned by the previous owners of Paramount Group, Inc.'s predecessor, reimbursed the Fund III Limited Partners for the full \$4.5 million of developmental expenses.

² Fund III's 2014 and 2015 financial statements disclosed the removal of the reimbursement requirement from the transaction and explained that, because the expected pricing was significantly exceeded and assumed in part certain residential development of the property, Fund III originally bore its own development expenses. These financial statements were provided to Fund III Limited Partners on April 30, 2015 and April 18, 2016, respectively, well after the March 2014 transaction, and did not constitute obtaining the Fund III IAC's consent.

VIOLATIONS

15. As a result of the conduct described above, Respondent willfully³ violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging “in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” A violation of Section 206(2) may rest on a finding of simple negligence. *SEC v. Steadman*, 97 F.2d 636, 643 n.5 (D.C. Cir. 1999) (citing *SEC v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

16. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit any fraudulent, deceptive or manipulative act, practice, or course of business by an investment adviser to an investor or prospective investor in a pooled investment vehicle. A violation of Section 206(4) and the rules thereunder do not require scienter. *Id.*, at 647.

RESPONDENT’S COOPERATION AND REMEDIAL EFFORTS

17. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded Commission staff during its investigation.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$250,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

³ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

D. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Paramount Group Real Estate Advisor LLC as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to C. Dabney O'Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary