

Expert Group on open ended real estate funds: Terms of Reference

1. Background

Investments in real estate assets have become increasingly popular, with institutional as well as with retail investors. This investment has taken the form of both direct investments in commercial or residential property or through indirect investment in commercial property funds and vehicles available to private investors.

In the past, indirect real estate investments were traditionally made through closed ended investment vehicles – fixed life funds in which there are no formal regular investment redemptions. These were often typically structured with a view to accommodating primarily an institutional investor base.

Increasingly now however Member States have developed open ended structures at national level to enable, inter alia, retail investors to gain access to indirect real estate investments, offering the risk sharing and diversification benefits of pooled investments, whilst also providing increased liquidity for investors seeking an exit to their investment. In 2005 the gross asset value¹ of EU closed ended and open ended real estate funds were approximately €110bn and €160bn respectively. Open ended real estate funds are currently subject to national regulatory regimes in almost half the 27 EU Member States.

However, open ended real estate funds cannot currently be authorised as UCTIS funds, and therefore cannot benefit from the UCITS passport. The fact that these funds are denied Single Market freedoms that are accessible through the UCITS Directive to other types of retail investment funds results in a limitation on the choice of investment product available to retail investors and may have negative consequences for competition and market efficiency. On the other hand, the need of ensuring a high level of investor protection should be equally taken into account, when considering any extension in area of UCITS eligible assets, or other changes to the UCITS framework.

The White Paper on enhancing the Single Market framework for investment funds adopted by the Commission on 15th November 2006² observes that important parts of the retail investment fund market still fall outside the scope of the current European framework. The Commission estimates that up to 10% of the retail investment fund market in Europe could fall into this category. The White Paper cites open ended real estate funds as an example of such a product. The Commission has undertaken to complete a systematic analysis of the non-harmonised retail fund landscape and report to the European Parliament and to the Council in 2008. The work of the Commission and of the expert group in respect of real estate funds will form an important part of this work.

The White Paper envisages the creation of an advisory group on real estate funds. The expert group would concentrate primarily on open ended real estate funds and report on the nature and significance of any barriers that may be hindering the development of these markets on a

¹ Source: INREV (European Association for Investors in Non-listed Real Estate Vehicles), Quarterly Report on non-listed real estate vehicles: August 2005. Alternatively, EFAMA estimates the total AuM for the European open and closed ended real estate sector at the end of 2006 to be c. €170.

² COM(2006)686final

cross border basis. The group will seek to determine whether EU-level action to facilitate the development of this business on a cross border basis would deliver meaningful benefits for industry and investors; it will explore different options for realising these perceived benefits and contribute to discussions on the cost-effectiveness of any proposed actions.

2. Mandate for the expert group

Scope

The expert group will focus primarily on open ended real estate funds. The market for closed end funds and other types of real estate vehicles (e.g. listed property structures) would be considered by this group only in so far as it is necessary and appropriate to do so when describing the European real estate fund markets and the types/variety of different products currently available to retail investors. The expert group should justify the rational and benefits for particular attention to Single Market arrangements for open ended real estate funds compared to other forms of collective investment in real estate.

Objective

The purpose of the expert group shall be to advise the Commission on matters relating to the European market for open ended real estate funds. The group's objective will be to establish and communicate to the Commission a report summarising its analysis and recommendations.

The expert group will provide technical, commercial and market analysis that could serve as a basis for debate with Member States and other stakeholders. The group's work will provide qualitative and, where possible, quantitative input to guide reflections in the following areas outlined in the Commission's White Paper and referred to in the Commission's Decision (published on the Commission's website).

Output

The expert group shall produce a report advising the European Commission which will be made public as a basis for discussion with Member State authorities, EU bodies and other stakeholders. The report shall reflect the consensus view of members of the group. The report shall not be considered as reflecting the views of the Commission services. On completion of the report, the expert group will be disbanded.

Indicative analytical framework

The expert group shall:

(i) Describe the current European market for real estate funds

The group will consider the different methods for undertaking collective investment in real estate and explain the particular relevance and role of open ended real estate funds compared to other methods for collective investment in real estate. They shall describe the features of different real estate funds, and if this is the case, explain why open ended real estate funds may be considered as a typical retail product.

The group will analyse the risks and features of open ended real estate funds and assess their potential relevance for retail investors and issue opinions on the suitability of open ended real

estate funds for holding in the portfolio of a retail investor. In this context it will take account of different classes/types of real estate investment.

(ii) Analyse the demand and supply

The group will analyse the current distribution of open ended real estate funds and the future potential cross border development of this market both from the supply and demand side, providing the necessary evidence.

(iii) Examine the barriers to cross border development

The group will examine existing barriers to cross-border distribution of open ended real estate funds and how these barriers could best be overcome. The group would also assess the different business practices with regard to real estate investment and the different legal concepts, including in respect of real estate ownership and leasing structures, the different risks arising therefrom, and the implications of this for devising a harmonized framework for the definition of "eligible assets" for a pan-European real estate fund framework.

(iv) Evaluate existing national approaches

The group would aim to identify what are the common characteristics of open ended real estate funds in the Member States and differences with regard to national regulatory approaches. This evaluation would include consideration of the following areas in respect of different national approaches:

- eligible assets of real estate funds
- fund investment limits and use of derivatives
- valuation of property and financial reporting systems
- liquidity management, prevention of a liquidity crisis, suspension of redemption
- leverage, and use of loans
- disclosure of risks, with particular attention to the risks incurred by retail investors
- taxation

(v) Identify and assess options

The group would consider whether open ended real estate funds could materially benefit from a single market framework and whether the lack of a harmonising framework is detrimental to consumers and industry. The group would describe ways in which benefits would arise and consider possible downsides such as additional costs and compliance requirements.

The group would explore what a harmonised regime for open-ended real estate funds should look like (e.g. separate section for open-ended real estate funds within the UCITS Directive versus a separate directive either for open-ended real estate funds or for all alternative investment funds) and provide a considered evidence based assessment of the likely benefits for industry and investors of creating a Single Market framework. It will also identify the main hurdles preventing the proposed solution to be successfully implemented.

(vi) Table proposals / recommendations

On the basis of the above analysis, the group will advise on possible cost-effective ways to enable open ended real estate funds to benefit from the Single Market freedoms. A key consideration will be to assess the cost-effectiveness of envisaged solutions and to examine whether it represents a superior outcome to a 'do nothing' option.

3. Composition

The group will comprise a maximum of 18 experts. The members of the group shall be appointed by the Commission on the basis of direct proposals from individuals, or nominations on behalf of those individuals from their respective employers or from national and/or European bodies representing industry and/or retail and institutional investors, which have a demonstrable and particular interest in the open ended real estate fund market.

4. Nomination of experts

Direct nominations

Following the Commission decision to create this group, the Commission services will publish a call for expressions of interest from interested individuals which can demonstrate relevant expertise. Prospective expert group members shall have four weeks to notify their interest to the Commission, either via direct nominations or by proposals on their behalf from their employer or a sponsoring representative body (trade and investor/consumer association). The expression of interest shall include information to allow the Commission to assess the suitability/expertise of the proposed individual expert having reference to the criteria set out below.

Experts will not be representatives of their respective entities, but will be independent.

Proposed experts must have expert knowledge in the field of open ended real estate fund markets. They may include representatives from professional services firms, legal advisors, other relevant operators which provide services to the open ended real estate fund industry; and investors (both institutional and retail).

Criteria governing the nomination of experts:

Proposed experts must have direct professional expertise in respect of the issues covered by these terms of reference as evidenced, in particular, by hands-on experience in commercial projects or matters relating to open ended real estate fund in respect of at least one of the following topics:

- Product development, manufacturing and structuring; and/or
- Due diligence, legal (including tax), investment, and asset management; and/or
- Fund servicing, administration, valuation, and property appraisal; and/or
- Distribution, marketing or placement; and/or
- Investment in real estate funds; and/or
- Investor/consumer protection in the investment/asset management area; and
- The extent to which proposed experts contribute to defining and shaping the views of their parent organisation in respect of the matters covered by the mandate.

The Commission shall assess the eligibility of the candidates against the above criteria.

Further relevant experience gained in the capacity of an industry advisor, investor or consumer representative, with national authorities in respect of open ended investment fund markets would be also be considered beneficial.

Final determination of committee composition

The Commission services shall be responsible for determining the final composition of the expert group based on the nominations received.

In making the final selection of group members, the Commission shall be guided by the need to ensure that, in addition to covering all main areas of expertise, the group has, to the greatest extent possible, a balanced geographical and gender composition.

The Commission will also seek to ensure that the group composition spans the range of relevant functions within the industry value-chain (fund promoters, asset managers, fund administrators, distributors etc) given the issues raised by the terms of reference. The Commission will also select experts whose background is more investor/consumer oriented. The Commission will also wish to ensure an appropriate multi-disciplinary mix within the group (lawyers, economists, tax specialists etc). However, the over-riding criterion will always be the extent to which individual experts have a track-record in dealing with commercial projects or problems of the type arising from the mandate.

Once the Commission services have arrived at a definitive selection of group members, they shall advise all individuals of their decision. The list of expert group members shall be made public prior to the commencement of its work.

5. Duration and location

The group's activities will begin in June 2007. The experts shall remain in office until such time as the report is concluded (see Art. 4 (6) of the draft decision).

Five plenary meetings will take place in Brussels on the Commission premises in accordance with the procedures and schedule established by it (see list of proposed meetings).

The report will be published by the Commission at the start of 2008.

Meetings/discussions may be held at other locations or via other communication means such as conference calls and/or e-mail exchanges.

6. Expenses of group members

The Commission shall reimburse travel and subsistence expenses for its members and observers in connection with the group's activities in accordance with the provisions in force at the Commission. The members shall not be paid for their duties.