EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

Tuesday 25th June 2013

Re: EFRAG consultation on 'long term investment activities' business model

Dear Sir/Madam,

EPRA represents commercial property companies that are quoted on the public stock exchanges of Europe and around the world. Our members are directly engaged in the development, long-term ownership, operation and management of commercial and residential property in Europe and globally.

Between them our 200 members own, manage and operate over €250bn of commercial and residential real estate. Our membership also includes the institutional investors such as pension funds and insurance companies that invest in listed property companies. EPRA actively responds to policy issues affecting our members including the IASB/FASB, European Commission, ESMA and national regulators, and various other organisations.

Executive Summary

We welcome the opportunity to comment on the EFRAG consultation on '*whether there is a need for specific financial reporting for long-term investing activities business models*'. Our strong view is that any proposed developments regarding 'long-term investment activities' should not compromise the current basis under IAS 40 which is widely regarded as providing useful and relevant information to the users of the accounts of property companies. We have the following key comments:-

- Listed property companies including 'REITs' are primarily engaged in managing, owning and operating commercial and residential property for long-term rental income and capital appreciation. In this sense they are clearly 'long-term' investors and should be of direct relevance to the EC Green Paper and EFRAGs consultation.
- Listed property companies and REITs are fully integrated operating businesses and should be distinguished from passive 'funds' or 'asset managers'. They combine intensive and active delivery of the end-product (the long-term provision of the built environment and related accommodation services) with a liquid and accessible investment vehicle through the medium of the public stock markets.
- The use of fair value reporting is well established in the listed property sector as a means to provide useful and transparent information to investors. The vast majority of our members (around 95%) report their investment property at fair value under IAS 40 *Investment Property* and use external valuers to undertake these valuations.
- The industry has also developed widely used industry metrics such as the EPRA Best Practices Recommendations [link] which are reported by over 90 companies including 90% of the FTSE EPRA/NAREIT Developed Europe Index. These include valuation based performance measures such as EPRA NAV, NNNAV and Net Initial Yield that have been developed in consultation with investors and analysts.

- Whilst we appreciate that fair value information can contribute to greater volatility and short termism, we strongly support the view that investors and other users would not be fully informed without this information which is used along with valuation based metrics to assess performance and make appropriate decisions.

- For example, the lack of transparency resulting from requiring assets to be reported at "cost" would contribute to a deterioration of the credibility of the sector and potentially limit access to credit if investors cannot accurately gauge the leverage of a borrower.

- We would therefore emphasise the point that any proposed developments regarding 'long-term investment activities' should not compromise the current basis under IAS 40 which is widely regarded as providing useful and relevant information to the users of the accounts of property companies.

We have attached our responses to the specific questions in the Appendix. If you have any questions please do not hesitate to contact myself on the details below or Gareth Lewis, EPRA Finance Director, at Gareth.lewis@epra.com.

Respectfully submitted,

EPRA
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Appendix - Response to Specific Questions

Question 1
Would you describe your (or one of your) business model(s) as a long-term investing business model? Please explain. If so, what is its economic purpose?

Yes, listed property companies including 'REITs' actively own, manage and operate property (primarily offices, retail, and residential) for the long term for rental income and capital gains.

Question 2
What are your long-term investing activities driven by (e.g. the need to back long-term liabilities)? What is the nature of your long-term commitments? How do you distinguish between assets held to back long-term liabilities and other assets? Are you also involved in trading activities? If so, to what extent and for what purpose?

The primary aim of listed property companies is to maximise rental income and capital gains and 'total returns' for investors (dividends and share price increases) over the long term. Like all companies, they raise both equity and debt capital (e.g. bonds, bank loans) and like any other business, aim to generate returns in excess of a company's cost of capital to ensure that they are increasing investors' wealth.

Question 3
What are the different types of assets you invest in?

Our members primarily invest in commercial buildings - mainly offices, shopping centres but also warehouses (storage and distribution), hotels and conference facilities, etc. They also invest in residential buildings and social infrastructure e.g. nursing homes, hospitals, prisons, and universities.

Question 4
How is your long-term investment strategy established and how do you report on it, for both transparency and stewardship perspectives? How do you ensure that your current or potential shareholders can make the link between how you report your investment long-term strategy and the information provided in your financial statements? Could such a link be improved? How?

Property companies seek to maximise 'total returns' through effective property and portfolio management (e.g. acquisitions and disposals), redeveloping and refurbishment activities, marketing and tenant selection, maintenance, and providing a quality service to tenants and all users of the real estate

The vast majority of our members (around 95%) report their investment property under the fair value model in IAS 40 *Investment Property*. We believe that fair value information is critical to both management and users in assessing performance and making appropriate decisions. For example, decisions to sell or retain property are largely linked to the fair value and related rental yield. Similarly, fair value is reflected in NAV measures (e.g. EPRA NAV) which are used by investors to assess if the share price is over or undervalued and motivate decisions to buy or sell the stock.

The industry uses a host of performance metrics such as the EPRA Best Practices Recommendations which are used by over 90 companies including 90% of the FTSE EPRA/NAREIT Europe Index. These include performance measures (EPRA NAV, Earnings per share, Net initial yields, Vacancy Rate), which are relevant to investors in a typical investment property business model.

Question 5
Do you believe the business model described above justifies a specific financial reporting treatment? If so, what should it be? Please explain how it brings relevant information to investors. Are there circumstances in which you would argue that fair value is not an appropriate measure? What other measurement attribute would you suggest and why (i.e. where a measurement basis in existing IFRS does not properly reflect the business model as described by you)? How should measurement uncertainty be dealt with in a 'long-term investment activities' business model?

EPRA and our members are broadly happy with the current accounting under IAS 40 *Investment Property* and IAS 17 *Leases* and the fair value model. Whilst we recognise that this results in greater volatility, investors and management understand this and require this information to assess performance and make effective decisions. We do not believe that not reporting the fair value is the solution as it would only compromise transparency and the usefulness of financial statements.

For example, credit rating agencies and investors rely on valuations and Loan to Value ratios to assess the viability of the company and its ability to repay debt. Not reporting the fair value could limit access to credit and undermine the efficiency of capital markets.

We recognise that in some instances determining fair value may be difficult. This may be the case in markets with few comparable transactions or with limited publically available information. However, there is a well established valuation profession, which we believe that alongside management should be able to reliably assess the fair value.

Question 6
If you are an investor in entities that are involved in long-term investment activities, what is the information that is the most relevant to you? How does IFRS financial reporting contribute to those needs today? Please explain.

EPRA represents the property companies or 'preparers' of the accounts. However, the widely used EPRA best practices recommendations (BPR) were developed in consultation with investors and analysts. These include recommendations for reporting performance measures that are tailored to investors in investment property companies:

1. Recommendation to report property at fair value and to use external value at least annually
2. 'EPRA NAV': includes adjustments to fair value all assets not at fair value
3. 'EPRA Earnings per share': aimed at showing the recurring income and adjusts for fair value movements.
4. 'EPRA Net Initial Yields': yield measures which provide a basis for comparable and consistent disclosure.
5. 'EPRA Vacancy Rate': a vacancy rate measure which can be used consistently across companies