

**EPRA response to the BaFin Consultation Paper
Geschäftszeichen (Konsultation 03/2013; WA 41-Wp 2137-2013/0001)
Betreff (Stellungnahme im Rahmen der Konsultation 03/2013)**

Introduction

The European Public Real Estate Association (EPRA) is the voice of the European publicly quoted real estate sector. EPRA represents listed property companies, (including REITs) who own, manage, acquire, sell, develop, refurbish, and operate commercial property. Our membership includes German listed property companies and G-REITs and also the investment institutions who invest in the sector and the firms and individuals who advise and service those businesses. Between them our 200 members own, manage and operate over €250bn of commercial and residential real estate.

We are very grateful to be given the opportunity to comment on BaFin's consultation paper on the interpretation of the term 'investment fund' for the purposes of the KAGB-E and have provided our comments below. The limited time available of just two weeks has meant that our response is not as detailed as we would otherwise wish for such an important topic that has the potential to completely redefine the way that our industry sector is characterized. We would therefore welcome the opportunity to meet at short notice with BaFin to discuss any of these points in more detail.

General comments

Since we became aware of the AIFMD's existence in 2009, the corporate real estate industry has endured a long period of uncertainty surrounding the application of the AIFMD – a situation which was not helped by a number of inconsistent statements from various regulators and governments regarding the scope of the Directive. After four years however, we had reached the position where we believed that the combination of primary legislation and ESMA guidance provided the right framework in which national regulators and governments should be able to implement an appropriate and broadly harmonized approach to the scope of the Directive across Europe. A general point we therefore think is important to make in relation to the scope of the AIFMD, is that the real estate industry is broadly happy with the EU-level legislation and ESMA developed regulation that is expected to be finalized shortly¹.

Executive Summary

EPRA and its global partners are alarmed with a number of BaFin's positions outlined at this very late stage in the process, in the consultation paper, which we believe are inconsistent with the ESMA guidance, other national regulator's interpretation of the AIFMD and the broader global capital market's view of listed (or unlisted) corporate property groups including REITs. The two main concerns are as follows:

1. BaFin's proposal that corporate property companies with G-REIT status are specifically within the scope of the AIFMD - because of conditions that the company

¹ Refer EPRA response to ESMA CP – Guidelines on the Key Concepts of the AIFMD:-
[http://www.esma.europa.eu/system/files/epra_response_to_esma-2012-845 - 22_01_13.pdf](http://www.esma.europa.eu/system/files/epra_response_to_esma-2012-845_-_22_01_13.pdf)

management comply with as a consequence of adopting and maintaining the beneficial tax status.

2. BAFIN's view that the business of producing, developing, refurbishing, owning and managing commercial and residential property for the long-term is not a commercial 'operating' business.

Our view is that the BaFin proposal to reclassify G-REITs as 'funds' and to view the business of producing, developing, refurbishing, owning and managing commercial and residential property for the long-term as not a commercial 'operating' business is the wrong conclusion and contrary to the objectives of the AIFMD. If implemented, the proposals would lead many genuinely commercial businesses to be incorrectly classified as 'funds' and be detrimental to the future growth of the German listed property sector, the efficiency of the broader German real estate sector and its critical role in supporting the German economy.

Detailed comments

G-REIT status irrelevant for scope of AIFMD

We strongly oppose BaFin's proposal that a G-REIT is specifically within the scope of the AIFMD 'because its statutory objective is similar to that of a real estate investment fund'.

We object to this view because we believe G-REIT tax status is irrelevant to the scope of the AIFMD and that any assessment of whether a business is an AIF should be undertaken on a case by case basis using the principles provided in the European Commission and ESMA guidance. Furthermore, we believe that a technical analysis of the current G-REITs in existence at the time of writing should conclude that these companies are not 'collective investment undertakings' nor do they have a 'defined investment policy'.

The AIFMD does not intend to regulate any activities other than fund management. We are aware of the reasons why regulators could confuse G-REITs with real estate funds – because the underlying business activities of real estate funds are similar to those undertaken by property companies and REITs. However, this approach misses a critical distinction from the investor's perspective which is fundamental to the identification of funds and appropriate implementation of the AIFMD across Europe; Real estate funds must have a clearly defined and fixed investment policy, on the basis of which they raise money and against which investors assess and reward their performance. Such funds cannot generally choose to change their investment focus from one sub-sector to another (for example, shopping centres to offices) or between assets with very different risk/return profiles. By contrast, there is no such constraint on listed property companies and G-REITs, who simply have a business strategy which offers the flexibility required by an operating business and which can in any event be changed from time to time, on a full opportunistic basis, by the management (attracting positive or negative reactions from investors and the market in general).

An assessment of whether these businesses are AIFs, or not, should focus on whether the entity is a 'collective investment undertaking' with a 'defined investment policy', rather than on a particular tax status.

The following points relate directly to the German listed property sector and support the above comments:-

- i. G-REIT status is a voluntary tax status. It does not require a company to be part of it, unless it elects to be so. The G-REITs in existence today were already long-established property businesses whose decision to convert to a REIT was a strategic business decision given the tax implications of becoming a REIT. The decision did not represent a change of style or form to fund management or a change in business objective.
- ii. G-REIT status is not part of the shareholder relationship for a G-REIT of itself (albeit a reason why a shareholder may wish to invest and a status the board of directors may wish to have) and shareholder consent is not a G-REIT requirement. Many other businesses have tax requirements. These are business considerations for their boards and REIT status should be regarded in a similar fashion rather than being a relevant criteria for identifying an AIF.
- iii. There are a number of German listed and unlisted property companies which did not elect to join the G-REIT regime but are otherwise largely similar as a business.
- iv. A G-REIT can cease to have REIT status at any time without shareholder involvement and still continue as a listed property company.
- v. Whilst the G-REIT tax regime does have requirements such as being listed, having a minimum amount of property investment business and paying dividends, failure to comply with them leads to tax consequences rather than constitutional ones or loss of listed status.

The following points relate to the broader European /global listed property sector and 'REIT' market:-

- i. Outside of Germany, 'REIT' status identifies a "brand" or tax status rather than a particular legal or corporate structure. REITs can take different forms and have different requirements according to their jurisdiction - they are not homogenous.
- ii. The 'REIT' term is invariably used to describe the listed corporate property sector more generally, whether or not a company has a special tax status.
- iii. The global investment community distinguishes between a listed property company and a fund – as being fundamentally different activities, but do not distinguish between a REIT and a listed property company.
- iv. There are separate trade industry associations in Europe representing the listed property companies and REITs (EPRA) and funds/fund managers (INREV) – which again, reflects the recognition within industry and the market that these are fundamentally different businesses.

In summary, the G- REITs in existence today are essentially the same as other German corporate businesses (e.g. a public limited company under the German Companies Acts), with their business focus being to operate in the property sector.

The fact that the G-REITs are listed and have chosen to be REITs under German tax legislation is part of their business strategy from time to time but should not be seen as any form of criterion that makes them an AIF. Their tax status is simply that and is opted for as a business decision.

They are entities acting for their own account. Their purpose is to own and manage their underlying assets with a view to generating value on a permanent basis using share capital, debt and retained earnings to fund their businesses. They develop, buy, sell and hold

property as continuing business. Their G-REIT tax status does not mean they should be treated differently, regulatory or otherwise, to other German corporates.

The section below is a technical analysis of the existing G-REITs as regards the identification of an AIF. It is clearly a possibility that a both future G-REIT and a property company without G-REIT status could meet the criteria of an AIF – due to its specific corporate construction, and its prescribed relationship with shareholders, including its marketing and promotion arrangements. However, our key point is that, according to the principles and objectives set out in the AIFMD and ESMA guidance, status as a G-REIT should not be a relevant criteria in identifying an AIF.

Technical analysis of the existing G-REITs

Collective Investment Undertaking

We support ESMA's statement in its Discussion Paper (DP12/1) and Consultation Paper (ESMA/2012/845) that a business which is acting on its own account and "whose purpose is to manage the underlying assets of a commercial or entrepreneurial activity" is not a collective investment undertaking.

G-REITs should not be regarded as "collective investment undertakings". G-REITs and other listed property companies carry on business for their own account. Unlike fund managers which manage a close and binding investor relationship, G-REITs have a more distant relationship with their shareholders. The shareholders receive dividends from income generated but are not involved in business strategy in any way. Capital raising is generally infrequent and for general corporate strategic reasons rather than a specific investment. As with other corporate businesses, G-REITs place importance on their customer (as well as investor) relationships as well as their staff and broader corporate social responsibilities.

Defined Investment Policy

We believe that the existing G-REITs should not be construed as raising "capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors". A G-REIT's obligations to its shareholders are no different to that of any other publicly listed company, including acting for its own account. The criteria proposed by ESMA further support this view.

G-REITs have an evolving business strategy which is for the board of directors to determine and do not have an investment policy which can only be changed with the consent of the shareholders.

The underlying business activity

As stated above, EPRA's view is that the concepts discussed in the ESMA draft guidelines provide a good platform for developing a sensible European-wide interpretation of the AIFMD. The right path to appropriately identifying the type of European and global businesses that are the intended target of the AIFMD is to focus on the unique relationship that a fund has with its investors, compared with that of a non-fund. For this reason, we support ESMA's focus on the development of further criteria to determine whether a particular business has a 'defined investment policy'. We also strongly support ESMA's

stated position that ‘concentrating on the asset classes of AIFs or the investment strategies applied to those asset classes is not the correct approach’².

We are therefore disappointed that BaFin appears to be following an approach of characterizing a particular business activity and underlying asset (in this case real estate) as being an ‘investment’ activity rather than an ‘operating’ activity. We strongly advise against taking this approach. We believe it unhelpful to introduce a bias towards the more the obvious commercial activities like, for example, product manufacturers and retailers. There are many commercial operating business activities that are capital intensive businesses like the real estate sector where terms like ‘investment’ and ‘property/asset management’ are regularly used and which might otherwise lead to a conclusion that these are funds. In our view, all corporate commercial/operating businesses essentially ‘invest’ shareholder’s capital in the same way; in the provision/production of the underlying asset, product or service as well as the various components needed to run a perpetual business as a going concern - employees, research, marketing, development of the business, its social values and public image, finance and administration functions etc. This is very different to a fund whose purpose is essentially to provide returns to investors that match the investment into the underlying asset.

It is confusing to us why BaFin considers the activity of developing and acquiring real estate with a view to subsequent sale, as an operating activity, but a similar activity with a view to leasing and managing the property for the long-term, as being indicative of an ‘investment fund’. Indeed, following this approach, a fund which carries out property development (targeting development opportunities, conceiving, acquiring and developing sites) – and there are many that do exactly that – should be considered an ‘operating’ business and therefore not within scope of the AIFMD. This is clearly a nonsensical outcome and highlights the dangers of an ‘activity-based’ approach to determining the scope of the AIFMD.

The mere fact that a business undertakes activities that are capable of being undertaken by a fund should not mean that it is a fund. A business carrying out basic real estate investment activities (e.g. owning, letting and managing real estate to derive rental income) should not automatically be treated as a fund, and it is in our view unhelpful to characterise a particular business activity and underlying asset (in this case real estate) as being an ‘investment’ activity rather than an ‘operating’ activity.

We believe that the BaFin paper is inconsistent with the approach taken by other regulators around the world. **Appendix I** details a number of interpretations of real estate ownership/management more generally, and specifically the business models of REITs, where the commercial/operating status of this business activity is clearly recognized.

Broader economic and policy considerations

The built environment – the space and infrastructure that provides for the needs of businesses, families, hospitals, schools, and leisure activities – is fundamental to Europe’s well-being by catering to its economic and social needs (see EPRA/INREV 2013 report [‘Real Estate in the Real Economy’](#)). The commercial property sector, including G-REITs, is directly

² Discussion paper - Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM - ESMA/2012/117

responsible for providing this essential service to Europe's businesses and citizens - directly employing 4 million people and contributing 2.5% to GDP.

As discussed further below, we believe an attempt to reclassify G-REITs as funds would have detrimental impact on the growth of the relatively underdeveloped German listed property sector. It would effectively constrain the listed property sector's ability to play the role it has proven to have performed in other global real estate markets – to drive and lead positive change in the transparency, professionalism, accessibility and innovation levels in the broader real estate market.

As highlighted above and evidenced in Appendix I, industry participants, including the property companies themselves, investors and regulators, recognize the difference between real estate funds and property companies and REITs that are active operating businesses.

In fact, the specific and unique attributes that listed property companies engaged in the long-term development, ownership and operation of the built environment bring to the economy have been recognized by governments all over the world. REITs are used as a policy tool by national governments to promote the growth of the listed property sector and as an effective means of channeling global capital into the built environment with a long-term focus. EPRA recently published a report entitled "[Stock Exchange Listed property Companies; Building a Stronger Europe](#)" which highlights the unique contributions that listed property companies (including REITs) make to the health, vibrancy, efficiency and accessibility of the European property market. The report also highlights the economic benefits that arise specifically as a result of the unique 'hands-on' business model of a REIT and listed property companies – the development, active management and operation of real estate, driven by long-term value creation objectives. For example:-

Production of the built environment:

- Relative to the size of their property portfolios, listed property companies devote two-to-three times as much investment to the development of new buildings and the improvement of existing buildings than the rest of the real estate industry.
- Listed property companies are major players in the most substantial, ambitious, capital-intensive and longest-term projects, meeting the accommodation and infrastructure needs of European citizens.
- EU listed property companies own or part-own and operate 32 of the top 50 shopping centres in developed Europe.

Intense and active delivery of service to businesses and communities:

- As perpetual businesses that operate continuously through many economic and property cycles, listed property companies activities are focused on meeting the long-term accommodation needs of businesses and communities. As such, they tend to undertake more dynamic management of the underlying property portfolio including development and refurbishment.
- Listed property companies employ almost four times as many people as fund managers, relative to the amount of property they manage.

Driving up standards - transparent and professional real estate markets

- A healthy and sizeable listed property sector improves the overall transparency of a country's real estate market. Those are the findings of the recent Jones Lang LaSalle's 2012 Global Real Estate Transparency Index covering 97 markets worldwide. High

standards of transparency in the listed sector have a positive influence on the rest of property market.

Front-runners in sustainability:

- Buildings account for 40% of energy consumption in Europe and one third of the continent's carbon emissions. Listed property companies are leading the industry in constructing energy efficient buildings, renovating to the highest standards or managing buildings better to lower energy and water consumption, as well as increase waste recycling.
- Real time pricing of their shares means listed property companies cannot afford to overlook the need to "future proof" their assets against obsolescence and regulatory risk. In contrast, "The finite life of some private funds may lead to a more short-term focus and may hinder investments in energy efficiency," according to the [Global Real Estate Sustainability Benchmark's 2011 annual report](#).

BaFin's proposal to classify G-REITs as 'funds' would, in our view, negatively influence the business models of REITs themselves- encouraging them to structure and function like the more passive, fund sector. This would in turn limit the German listed property sector's ability to deliver the types of economic benefits enjoyed by those economies with larger listed property sectors and highlighted above. We believe it would also ensure that the German listed property sector will never develop to a size more comparable with other global developed markets.

Conclusion

The real estate sector has been adversely impacted by the uncertainty surrounding the AIFMD scope for over four years. Both real estate funds and property companies have been engaging with the European Commission, National regulators including BAFIN and Governments for over four years on the question of determining an appropriate scope boundary around the real estate sector.

Not once during that time has it ever been stated by a regulator or government official that the business of developing and managing real estate is not a commercial business.

It is therefore very alarming to us that, even before the ESMA position is finalized, BaFin are taking such an inconsistent and unexpected position on property companies and REITs that goes against previous statements from European regulators. The effect is to reintroduce market uncertainty that was beginning to dissipate.

By way of an example, if the global REIT and listed property companies were to be treated as closed-end retail Alternative Investment Funds, an established market with over 1.2 trillion of EUR market cap and worldwide trading of approximately EUR 2 billion per day would be at risk of being subject to not only severe marketing limitations for issuers and distributors, but also purchasing limitations for institutional and retail investors in Germany. This would be a dramatic outcome given that those entities are already subject to all rules for the regulated stock market listing and trading.

Although Germany has a very small listed property sector compared to other European and global regions, it will be an extremely influential voice in the interpretation of the AIFMD. Despite the comment that the BaFin position refers to G-REITs only, if the proposals remain

in place, it should not be underestimated how influential this could be on the approaches taken across other European countries – even those member states with larger, more familiar listed property/REIT sectors where there is less scope for confusion. If this were to occur, and the broader European approach was that ‘REITs’ or property companies were deemed to be funds, then the detrimental effects for the German built environment and economy as described in this paper, would be multiplied across Europe.

We would therefore respectfully urge BaFin to reconsider its approach to G-REITs and the position taken on the business model of developing and managing property for the long term.

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Organisation	Relevant statement	EPRA Comments	Ref:
European Union			
ESMA:	"ESMA has determined that concentrating on the asset classes of AIFs or the investment strategies applied to those assets classes is not the correct approach in determining the type of fund that would constitute an AIF"	Contrary to ESMA, BaFin distinguishes between specific real estate related activities. Project development (design, acquisition, development and subsequent sale of the developed property) is regarded as 'operative' activity. The acquisition, lease and management as well as the sale of property, however, are not considered operative activities.	Para 23 – ESMA Discussion paper - Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM - 23 February 2012 ESMA/2012/117
European Commission:	"The question whether or not a listed real estate investment company is excluded from the scope of the AIFMD depends on whether or not it falls under the definition of an 'AIF' in Article 4(1)(a). Real estate companies cannot be excluded as such a priori, each situation needs to be valued on its own merits, based on substance, not on form. " (emphasis added)	This statement supports the view that each property company, whether listed, unlisted, with G-REIT status or otherwise, should be considered against the AIF criteria. We believe BaFins approach to define G-REITs (all existing and future forms) as a class of business that is an AIF, is contrary to this position.	EC Q&As on Articles of the AIFMD
Germany: Dr. Thorsten Pöttsch p.p. Head of Department VII – German Federal	English translation of original:- "My understanding is that REITs and Immobilienaktiengesellschaften will not be regulated by the AIFM Directive. Nor are there any indications to date that the EU Commission has a different understanding of	The statement supports both the operational, 'entrepreneurial' nature of REITs, the fact that they are not engaged in fund management activities and that the G-REIT status should not be	Available on request

Ministry of Finance	<p>the Directive in this respect. According to Article 4(1XbXi) of the AIFM Directive, the purpose of an alternative investment fund is to collect capital from several investors and to invest it for the investors' benefit in accordance with the defined investment strategy. However, REITs and Immobilienaktiengesellschaften are entrepreneurial organisations which administer the shareholders' contributions on their own account and not primarily on that of the investors. REITs and Immobilienaktiengesellschaften should be classified as entrepreneurial rather than as governed by investment law. Otherwise, other Aktiengesellschaften with a different line of business would also have to be classified under the AIFM Directive, which is ultimately not the regulatory aim of the Directive."</p>	<p>considered as relevant determining factor in distinguishing whether any particular business is an AIF.</p>	
Industry standard setters			
<p><i>International Accounting Standards Board (IASB): International Financial Reporting Standards (IFRS)</i></p>	<p>"[Company X] is not an investment entity because: it has a separate substantial business activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation and/ or investment income."</p>	<p>IASB project to identify those entities that manage investments on behalf of investors rather than entities that are engaged in the underlying commercial business itself (similar characteristic to AIF). IASB's clear conclusion is that this type of typical G-REIT activity would not be an investment entity.</p>	<p>International Financial Reporting Standard – Investment Entities – Illustrative Examples (page 60)</p>

Market participants			
Investors:	<p>“[T]he original [US]REIT structure created in the 1960s was a passive investment vehicle; it prohibited the operation and management of properties by the REIT itself. Over the years, however, legislative and tax code changes have enabled REITs to become actively managed, fully integrated operating companies....</p> <p>When REITs were passive investment vehicles, all that mattered was asset performance. Now that REITs are bonafide operating companies, management has the power to improve or, conversely, weaken that operating performance, as well as that of the overall enterprise. Good management aims to produce significant and efficient returns for the REIT’s portfolio, and guides the REIT through difficult markets.”</p>		<p>REITs 101: An Introduction, Barclays Capital Equity Research (April 7, 2010).</p>
Standard & Poor’s: Global Index provider (including the S&P 500 – the world’s most followed stock market index)	<p>Standard & Poor’s statement that “Standard & Poor’s believes that REITs have become operating companies, subject to the same economic and financial factors as other publicly traded U.S. companies listed on major American stock exchanges.”</p>	<p>Currently, 14 REITs are included the S&P 500, 25 are included in the S&P 400 and 27 are included in the S&P 600</p>	<p>Bill Barnhart, Tech Stocks Show Way for Market, Chicago Tribune, Oct. 4, 2001, available http://articles.chicagotribune.com/2001-10-04/business/0110040235_1_s-p-stock-indexes-tech-stocks-show</p>
Other:-			
US Internal Revenue Service:	<p>In 2001, the IRS recognized the fundamental change in REITs that Congress made in 1986 by</p>	<p>The original REIT structure, as enacted in 1960, was a passive</p>	<p>Rev. Rul. 2001-29, 2001-26 I.R.B. 1348.</p>

	<p>modifying its 1973 advice to conclude that a REIT “is permitted to perform activities that can constitute active and substantial management and operational functions with respect to rental activity that produces income qualifying as rents from real property.”</p>	<p>investment vehicle, A long series of legislative reforms followed such that the modern US REITs are fully integrated operating companies and recognized as such by the market participants and regulators.</p>	
<p>United States Government:</p>	<p>In 2006, all three North American governments changed NAICS to move “equity REITs” (REITs that focus on operating rental real estate) from the financial vehicle sector to the “Lessors of Real Estate” sector, where the SIC system and NAICS had traditionally classified active real estate operators.</p>	<p>Standard Industrial Classification (SIC) system is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.</p>	<p>71 Fed. Reg. 28533 (March 16, 2006). These changes became effective in 2007.</p>
<p>US Commodity Futures Trading Commission:</p>	<p>“the Division believes that REITs that primarily derive its income from the ownership and management of real estate and uses derivatives for the limited purpose of ‘mitigating their exposure to changes in interest rates or fluctuations in currency’ are outside the definition of ‘commodity pool’ under Section 1a(10) of the CEA and Commission Regulation 4.10(d)”</p>	<p>US CFTC agree with NAREIT position that because Equity REITs hold, develop and operate real estate, they are not commodity pools but rather operating companies</p>	<p>US CFTC letter to NAREIT of 10th Nov 2012</p>