

EUROPEAN REAL ESTATE INVESTORS GROUP

To: Carlos Tavares
Vice-Chairman
European Securities and Markets Authority

Copy: Uwe Eiteljoerge
Financial Services Policy and Financial Markets
European Commission

12 January 2011

Dear Sirs,

Implementing measures on the Alternative Investment Fund Managers Directive

The European Real Estate Investors Group (“EREIG”) represents the interests of a group of institutional real estate investors. Our members have invested in a range of funds with underlying real estate investments. These funds are mostly unlisted closed-ended, but with some open-ended and listed. Our members include institutional pension funds, insurance companies and fund-of-fund organisations, and operate in their domestic EU and (in many cases) several other EU markets.

EREIG has made several submissions on the proposals for an Alternative Investment Fund Managers Directive (“AIFMD”) issued by the European Commission, the Council of the European Union and the European Parliament.

We welcome the opportunity to respond to the Call for Evidence dated 3 December 2010 and would be pleased to assist the European Securities and Markets Authority (“ESMA”) in the development of its draft advice on the content of the implementing measures.

We suggest that ESMA should address the need for specific provisions relating to real estate funds and their managers, given that in several respects real estate funds differ from other funds and managers regulated by the AIFMD. In particular, such specific provisions should appropriately protect investors’ interests and minimise the risk of adversely affecting the efficient operation of such funds. We suggest that ESMA look to focus on the specific provisions against the background of the indirect real estate investment industry. The responses indicated below are of a high level nature. We would welcome the opportunity to elaborate on those responses – and, in doing so, co-ordinate with other parties including INREV (the European Association for Investors in Non-Listed Real Estate Funds).

Questions for the Call for Evidence

- 1. Which categories of investment manager and investment fund will fall within the scope of the Alternative Investment Fund Managers Directive in your jurisdiction? Please provide a brief description of the main characteristics of these entities (investment strategies pursued, underlying assets, use of leverage, redemption policy etc).**

Our members have invested in a range of funds with underlying real estate investments, i.e. land and buildings. The funds are mostly unlisted closed-ended, but with some open-ended and listed. Our members in general pursue medium to long-term investment strategies, as opposed to short-term strategies. They are attracted by the relatively stable income return offered by investments in real estate funds and the fact that the funds feature diversification characteristics not found in other asset classes.

The funds can deploy an element of leverage which can be relevant for structuring purposes (e.g. a tax shield) and, in the case of open-ended funds, for liquidity management purposes. However, members look for the extent of leverage and other risks to be properly managed and for the leverage not to be excessively deployed.

2. Among the topics that will be covered by the implementing measures, which do you consider would be most appropriately adopted in the form of regulations or directives? Please explain your choice.

Real estate funds – and institutional investors in such funds – increasingly operate on a pan-European basis, rather than solely within an EU domestic market. EREIG welcomes the AIFMD provisions which promote the EU single market and enable real estate fund managers to utilise a passport for promoting and managing funds on a cross-border basis. However, the practices adopted by managers in operating funds can vary between different EU domestic markets. This is particularly the case in relation to valuation practices and the calculation of the net asset value per share or unit.

EREIG would prefer the level 2 implementing measures to be adopted as directives, rather than regulations. We suggest that this would give EU Member States appropriate discretion to accommodate the various practices adopted by managers in operating funds.

3. Can you identify useful sources of data and statistical evidence from which CESR could benefit in the preparation of its advice?

We suggest you access data and statistical evidence from INREV and IPD: www.ipd.com. IPD is a specialist organisation focused on compiling – and independently verifying – data related to real estate funds, including their valuation practices. In relation to real estate managers reporting on risk profiles associated with their funds for the purposes of the AIFMD, we suggest that the findings of their research ‘RISK WEB 2.0: an investigation into the causes of portfolio risk’ (November 2010) could be utilised, and we are in dialogue with IPD in this respect.

Part I: General provisions, authorisation and operating conditions

Issue 1 – Article 3 Exemptions

Issue 1 a) – Opt-in procedure for AIFM below the threshold

We suggest that the authorisation procedure for an AIFM that chooses to opt in should be equivalent to that for an AIFM that is required to apply for authorisation.

There should also be equivalent procedures for an AIFM from a third country seeking to opt in after the phasing-in of the third-country requirement.

Issue 1 b) – Thresholds – calculation, oscillation, obligations below thresholds

1-2: We suggest that the audited annual report for each AIF should be utilised for calculation of the value of an AIFM’s assets under management

3. In the case of real estate funds – irrespective of the use of different forms of leverage – assets under management should relate to the relevant valuations for the underlying real estate investments.

4. No comments.

5. We suggest that the AIFMD ordinarily should apply to an AIFM whose total assets under management occasionally exceed and/or fall below the relevant threshold - subject to the national regulator being

entitled, on the basis of EU criteria, to waive such application when total assets under management occasionally exceed the relevant threshold. In the latter instance, the AIFM would have to apply to the regulator for a waiver and justify such waiver.

For the purposes of calculating the capital requirements of an AIFM in accordance with the value of the portfolios managed by that AIFM under article 6a, we suggest that any assets under management that represent underlying assets of funds benefiting from the grandfathering provisions in article 51(3) and (4) be excluded from the calculation.

6-8 (inclusive): No comments.

Issue 2 – Article 9 Initial capital and own funds

1-3: We suggest adopting an approach consistent with the Insurance Mediation Directive.

4: No comments.

Issue 3 - Article 12 General principles

We agree that ESMA should target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

Issue 4 - Article 14 Conflicts of interest

We agree that ESMA should target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

Issue 5 – Article 15 Risk management

We agree that ESMA should target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

Issue 6 - Article 16 Liquidity management

1: Investors in open-ended real estate funds will typically recognise the challenges arising from the fact that underlying investments in real estate are relatively illiquid.

We suggest that AIFMs should accordingly comply with appropriate liquidity management provisions which are robust in the context of different market conditions. These provisions should allow flexibility regarding redemption policies and (in exceptional circumstances) discretion on timing and price attributed to redemptions which are fair to continuing and redeeming investors.

Overall, we agree with the goal of alignment of the investment strategy, liquidity profile and redemption policy. In practice, we recognise that liquidity management policies can include a range of mechanisms, such as notice periods, deferrals, gates and (in exceptional circumstances) suspension.

Issue 7 - Article 17 and Article 61 (new Article 50a in UCITS) Investment in securitisation positions

No comments.

Issue 8 – Section 2 Organisational requirements, Article 18 General principles

We agree that ESMA should target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

Issue 9 - Article 19 Valuation

1: We recognise the variations in the valuation practices adopted by real estate fund managers and this has implications when calculating the net asset value per share or unit.

One valuation approach is based upon actual or estimated cash flow, e.g. generated in the form of rent. The estimated cash flow is used to estimate the value using a discounted cash flow model, with the discount rate reflecting then current market yields. Another valuation approach is derived from comparisons with recently transacted real estate investments currently available in the market.

We suggest that ESMA have regard to principles of good valuation practice for real estate established by the International Valuation Standards Council.

The calculation of the net asset value per share or unit should follow the practice adopted for funds in other sectors, with a buy-sell spread reflecting the relative liquidity of the share or unit.

2: We suggest that the form of professional guarantee be addressed with relevant professional organisations representing external valuers. We are concerned that the cost of such guarantees may outweigh their benefit to investors.

3: Retail open-ended real estate funds typically value no more frequently than on a monthly basis, yet often allow daily issuance and redemption. We suggest that more frequent valuation assessments would not provide any meaningful value for calculating the net asset value per share.

We would also question the merit of valuation being required upon an increase of capital of an AIF. Typically, investors in a closed-ended fund will admit a new investor and take more equity from an existing investor on the basis of a cost plus a late entry charge (rather than marking the underlying investments to market each time).

Issue 10 – Article 20 Delegation of AIFM functions

1: We agree that ESMA should target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

2: In the case of real estate funds, there should be greater clarity as to which real estate fund management functions (as opposed to the real estate asset management functions) will be subject to the AIFMD provisions on delegation and sub-delegation.

Part II: Depositary (Article 21)

Issues 11 – 18

No comments.

Part III: Transparency Requirements and Leverage

Issue 19 - Article 4 Definition of leverage

1 & 2: We consider that coverage through long-term borrowing should be distinguished from leverage embedded in derivative positions, given their different risk profiles.

We suggest that the method or methods for calculating leverage should reflect the different forms that leverage can take.

We also suggest that short-term bridge finance deployed by an AIFM for cash management purposes should be excluded from the concept of leverage.

Issue 20 - Article 22 Annual report

No comments.

Issue 21 - Article 23 Disclosure to investors

We suggest that the frequency of the relevant disclosures should be consistent with the frequency of applicable valuations of the underlying investments. We favour comprehensive criteria for assessing the liquidity of assets, and suggest utilising international accounting standard IFRS7 when appropriate.

Issue 22 - Article 24 Reporting obligations to competent authorities

See response to Issue 20.

Issue 23 - Article 25 Use of information by competent authorities, supervisory cooperation and limits to leverage

We suggest that – particularly since the recent market turmoil – the level of leverage on secured borrowers is satisfactorily controlled by regulations applying to banks and other debt financiers. The AIFMD implementing measures should be consistent with such measures, and not impose additional leverage limits.

Part IV: Supervision

Issue 24 - Cooperation arrangements between European competent authorities and the authorities of third countries

We suggest the framework should be consistent with the national placement regimes and any existing bilateral arrangements between individual Member States and third countries.

Issue 24a - Cooperation arrangements without a third country passport

No comments.

Issue 24b - Cooperation arrangements with a third country passport

No comments.

Issue 25: Cooperation and exchange of information between competent authorities

No comments.

Issue 26: Authorisation of non-EU AIFM

We suggest an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID.

EREIG hopes that the above comments are of interest and would be pleased to discuss the contents of this letter in greater detail. In terms of progressing the discussion, please initially contact the EREIG co-ordinator.

Yours faithfully

European Real Estate Investors Group

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