

Recommendations for the Consistent Implementation of the European Commission's Regulation on Prospectuses, No 809/2004



Response to The Committee of
European Securities Regulators
Consultation Paper

October 2004

Introduction

- 1.1 This document, submitted in October 2004, represents the joint response by the three leading property membership organisations in the UK, namely the Investment Property Forum ("IPF"), British Property Federation ("BPF"), and The Royal Institution of Chartered Surveyors ("RICS") to the Committee of European Securities Regulators ("CESR") Consultation Paper ("CESR Con Doc") on Prospectuses to be published when securities are offered to the public or admitted to trading.
- 1.2 This response represents a further phase in the dialogue between these organisations, who continue to act in unison so as to provide a single representative 'voice' for the UK real estate industry in relation to the potential introduction of UK Real Estate Investment Trusts ("REITs"), and the various national and supra-national agencies and government bodies who are likely to be involved with the introduction, management and regulation of such vehicles.
- 1.3 However, the three groups recognise that individual organisations and practitioners should, as they deem appropriate, respond separately to the CESR.
- 1.4 We welcome CESR raising the issues addressed in this ConDoc and in providing the real estate and wider investment management industry the opportunity to respond to the questions raised in respect of real estate prospectuses in light of the potential growth in such activity as REIT style vehicles are adopted in the UK and across the EU.
- 1.5 In submitting this response we have sought to ensure, as much as practicable, a consistent approach to the subject area in line with our response to the March 2004 ConDoc¹ submitted to HM Treasury in July 2004 ("Industry Response to the March 2004 ConDoc") and our response to the UK Inland Revenue Technical Paper of September 2004².
- 1.6 This response focuses solely on the issues raised in the CESR ConDoc that have particular relevance to the UK real estate industry and, in particular paragraphs 143 to 155 inclusive. It therefore does not provide responses to all of the questions posed in the CESR ConDoc.
- 1.7 Furthermore, our response to the recommendations and questions set out in respect of Property Companies have been prepared solely in the context of the UK market environment and UK Listing Authority ("UKLA") regulations that currently pertain with particular regard to Chapter 18 of the Listing Rules governing property companies. Where appropriate, however, we have sought to highlight issues in this area which may have wider EU implications.

¹ "Promoting more flexible investment in Property: A Consultation", HM Treasury, March 2004

² "The Tax Implications for Authorised Investment Funds following the New FSA Regulations (COLL)" – Inland revenue, September 2004

Parties to the Submission

2.1 Between them, the organisations submitting this joint response represent the majority of the UK commercial and residential real estate industry not only by number of individuals (on a multi disciplinary basis) but also in terms of value (including wide representation from both the institutional, as well as listed, real estate sectors). Thus:

- **Investment Property Forum** - Set up in 1988, the IPF is now recognised as one of the leading specialist property industry bodies in the UK. It comprises an influential network of senior professionals all active in the real estate investment market. The membership reflects the strength of the organisation with its diversity of individual (as opposed to corporate) members who now total circa 1,500. Members include investment agents, fund managers, bankers, lawyers, researchers, academics, actuaries and other related professionals.
- The Forum's mission is to improve the awareness, understanding and efficiency of property as an investment for members and others in the wider business community by: undertaking research and special projects; providing education; and, by encouraging discussion and debate.
- **British Property Federation** - The membership of the BPF now comprises a broad range of listed and unlisted institutions, asset managers and investment banks, as well as other organisations which are involved in the property industry such as agents, lawyers, accountants, consultants and project managers.
- In addition, the membership of the BPF includes an increasing number of institutions and individuals which invest in the residential property market. The BPF estimates that its members hold property assets and funds under management invested in property with a value equal to approximately £250 billion.
- **The Royal Institution of Chartered Surveyors** – The RICS is regulated by Royal Charter with the objective of promoting the public good. This allows the RICS to comment independently on matters relevant to its profession. The RICS numbers over 100,000 members who work in both the public and private sector and are involved in all aspects of land, property and construction.

Summary

- 3.1** In preparing this response, we have taken account of the already finalised new EU Prospectus Directive that will apply to prospectuses from 1 July 2005 but have focused on the proposals set out in the CESR CoDoc, which will also take effect on 1 July 2005, but which are still up for consultation. Both documents will, however, apply whenever securities are admitted to the Official List and to trading on the London Stock Exchange's market for listed securities.
- 3.2** In summary, in our opinion, the scope of application of the regime proposed by CESR and under the new Prospectus Directive is broadly similar to that currently captured in Chapter 18 of the UK Listing Rules, although it will apply to all securities offered by a property company, be they shares, debt, or anything else, if those securities are to be listed or offered to the public anywhere in the EU.
- 3.4** At present, the valuation report requirements in Chapter 18 only apply to new applicants or those raising money in a secondary offering who make significant reference to the valuation of property in their document. In practice, we suspect that this extends to all capital raisings made by property companies in any event, but this will be the effect of the new prospectus regime. However, as is presently the case, where a secondary offering of securities is less than 10% of the existing class, no prospectus will be required, so small listed offerings will still be possible without falling foul of these provisions.
- 3.5** The new regime will also apply to public offers of unlisted securities and impose the same disclosure obligations applicable to a listed offer (although this would extend to offers of unlisted securities to investment professionals, which will still be possible on a private placement basis).
- 3.6** In terms of the substantive disclosure obligations proposed, apart from the fact that under the CESR proposals there is much less prescriptive detail than currently contained in Chapter 18, the only other changes are considered to be relatively minor.

Section 1A Property Companies

Overview

- 4.1 Para 143 and 144 of the CESR ConDoc set out the background to its review of material to be contained in prospectuses as it relates to the valuation of property company portfolios.
- 4.2 Specifically these are:
- 4.3 Para 143: “On document CESR/02-185b, CESR consulted on property companies considering as such those companies that are primarily engaged in property activities, including the holding of properties, both directly and indirectly and development of properties for letting and retention as an investment, the purchase or development of properties for subsequent sale or the purchase of land for development of properties for retention as investment. For this definition, property means freehold, heritable or leasehold property or any equivalent.”
- 4.4 Para 144: “Additionally, CESR considered that the specific characteristics of property companies should be dealt in a valuation report to be prepared and disclosed as near as possible of the issuance of the securities, therefore, in the securities note. Bearing in mind that this requirement could make the prospectus too extensive (because some companies might have a large number of properties) CESR is now proposing that for companies that own more than 60 properties, only a condensed report shall be included in the prospectus insofar the entire report is made available as a document on display. CESR is also proposing that an independent expert prepare the report, in line with other requirements for independent expert reports.”

CESR Recommendations

- 4.5 Paras 145 to 149 of the CESR ConDoc set out the proposed CESR recommendations with relation to property companies which are set out below together with our comments / response to each of the proposals.
- 4.6 *Para 145: “Considering the specific features of property companies and in order to comply with article 5.1 of the Prospectus Directive and 23 of the Regulation, CESR proposes that property companies include in their prospectus (preferably in the securities report) a valuation report”.*
- 4.7 We would comment that this seems sensible and appropriate as it provides prospective investors the information necessary to make an informed judgement.
- 4.8 *Para 146: “Property companies are those issuers that are primarily engaged in property activities, including the holding of properties, both directly and indirectly and development of properties for letting and retention as an investment, the purchase or development of properties for subsequent sale or*

the purchase of land for development of properties for retention as investment”.

- 4.9** We would comment that, helpfully, both the definitions of "property companies" and "property" are very similar to those set out in existing Listing Rule 18.2 and therefore the recommendations in this area pose no particular issue or concern. With respect to the potential introduction of UK REITs, assuming the enabling is structured in line with the Industry's response to HM Treasury's Consultation Document, then this broad definition of a property company to include an organisation undertaking development is considered relatively beneficial.
- 4.10** *Para 147: “For the purposes of this definition, property means freehold, heritable or leasehold property or any equivalent”.*
- 4.11** We would comment that this seems sensible, though would recommend that the definition is extended to include expressly real estate related securities, including derivatives, in recognition of the investment criteria of many existing UK vehicles and the potential growth in “REIT of REIT” vehicles that are expected to follow the introduction of the appropriate legislation in the UK.
- 4.12** *Para 148: “This valuation report must:*
- 1 - be prepared by an independent expert;*
 - 2 - give the date or dates of inspection of the property;*
 - 3 - provide all the relevant details in respect of each property necessary for the purposes of the valuation;*
 - 4 – be dated and state the effective date of valuation for each property, which must not be more than 60 days prior to the date of the publication of the prospectus;*
 - 5 – include a summary showing separately the number of freehold and leasehold properties together with the aggregate of their valuations (negative values must be shown separately and not aggregated with the other valuations; separate totals should be given for properties valued on different bases);*
 - 6 – include a statement reconciling the valuation figures with the equivalent figure included in the issuers latest published individual annual accounts or consolidated accounts, if applicable.”*
- 4.13** Dealing with each of these points in turn, we would firstly comment that, as is the case under the existing UK Listing Rules requirements, the CESR proposals require a property company to include a valuation report prepared by an independent expert when it publishes a prospectus.
- 4.14** However, within the CESR recommendation there appears to be no indication of what is meant by "independent" in this context, whereas under

existing UK Listing Rule requirements the valuation must be carried out by an external valuer (as further defined in the RICS Manual). In our opinion, this definition has worked effectively within the UK and should be retained – clearly across the rest of the EU, however, where there are no similar national professional bodies the nature of this independence might have to be more clearly defined.

- 4.15** Furthermore, under the CESR proposal it appears that the UKLA would no longer have scope to permit the company's internal valuer to carry out the valuation as they are unlikely to be considered "independent". In our opinion, this is a clear loss of flexibility for UKLA but is not illogical.
- 4.16** With regard to point 2, the CESR ConDoc is not clear whether this is the date of the valuation itself, or of the actual physical inspection of the assets. In our opinion, so long as the former is clearly stated (and so as to comply with the 60 day timing requirement) the latter is not necessary nor feasible. Furthermore, the valuers certificate should of itself provide the necessary comfort as to the nature and value of the asset as at the struck valuation date.
- 4.17** Point 3 deals with the necessary level of required details in the valuation report. As stated, other than a requirement to give "all the relevant details" in respect of each property, there is no other specification as to what details should be included in the valuation report or how the report should be prepared, i.e. none of existing Listing Rules 18.10-18.16 are reproduced and there is no requirement that the valuation be carried out in accordance with the RICS manual.
- 4.18** The effect of this CESR proposal is that the UKLA *may* no longer be able to compel the inclusion of the specific details it currently requires in these Listing Rules. The requirement of EU law on which this is based gives the UKLA some flexibility on what information it requires from property companies although it also requires CESR to seek convergence on these requirements across the EU.
- 4.19** In our opinion, it is not clear whether the CESR position will be viewed as a maximum harmonisation position, i.e. each member state cannot require anything that is not included in the CESR proposal. The approach reflected in the ongoing Financial Services Authority ("FSA") consultation on the Listing Rules and the prospectus directive (CP203 and CP04/16) is that the draft new Listing Rules relating to the content of Prospectus Regulations will simply incorporate the content requirements made under the Prospectus Directive. Accordingly, if a more detailed description of the information to be included in the valuation report is required this will need to be included in the CESR recommendations.
- 4.20** Turning to point 4, the effective date of the valuation, the CESR proposal that the effective dates of the valuations must be not more than 60 days prior to the date of publication of the prospectus is longer than that of the 42 days in current Listing Rule 18.10(e). In our opinion, the 42 day rule in the UK works effectively though consider that any change to a slightly longer period is unlikely to have a material impact.

- 4.21** With regard to points 5 and 6, we would merely note that under Listing Rule 18.17 a summary of the valuations must also be included.
- 4.22** Finally, over and above the comments noted above, we would also highlight the fact as is presently required in Listing Rule 18.6, where appropriate, any valuations in a prospectus must be reconciled to the equivalent figure in the company's last published accounts. We would recommend that, where appropriate, that this requirement is maintained across the European jurisdictions.
- 4.23** *Para 149: "If the company holds more than 60 properties, only a report in a suitably condensed format needs to be included in the prospectus but the full report must be made available as a document on display".*
- 4.24** We would comment that under this recommendation, if a company holds more than 60 properties a condensed format of the valuation report can be included provided the full report is available on display. Consideration should be given to provisions prescribing the place at which such a condensed format valuation report be held on display and the relevant period (the current UK Listing Rules require display documents to be available during normal business hours in or near the City of London for at least 14 days from the date of the listing particulars, or for the duration of the offer, if longer).
- 4.25** The current UK Listing Rule requirement permits a condensed valuation report where the properties held are "too numerous". Although the CESR proposal has the benefit of certainty, it lacks any flexibility, which is probably intended to prevent regulators applying the directive requirements on an uneven basis.

Questions

Para 150 Q: "Do you agree with the usefulness of requesting a valuation report in general? Please state your reasons."

- 5.1** Yes – it is a critical and material part of the assessment of the offer provided to prospective investors (see para 4.7 above) and represents information that they have been used to seeing in relation to previous offerings.

Para 151 Q: "What rules do you think the report should comply with (such as those of the country of the competent authority that approves the prospectus or other different rules)? Please state your reasons."

- 5.2** We believe that the valuation report should comply with rules of the competent authority that approves the prospectus as it would be impractical to require the competent authority of any Member State to approve prospectuses containing information prepared in accordance with the rules of another Member State.

- 5.3** In respect of this issue, the UKLA regime is based upon the degree of professional rigour associated with RICS valuation standards and procedures is a valuable part of investor protection. Hence, they should be retained.

Para 152 Q: “Do you think the condensed report should be allowed if the company holds more than 60 properties or would you choose another figure? Please state your reasons.”

- 5.4** There is no particular number of properties within a portfolio that we would suggest beyond which a condensed report should be permitted because it is the nature and context of the buildings within the portfolio that is important. For example, all of the value may be in just two or three properties and this needs to be able to be demonstrated. Accordingly, we prefer flexibility for local listing authorities.

Para 153 Q: “Do you think a valuation report is needed with respect to each property or do you consider a condensed report as sufficient? Please state your reasons.”

- 5.5** See our response in para 5.4.

Para 154 Q: “Considering the objective of the report, do you think it can be older than 60 days?”

- 5.6** It is appropriate for there to be a limit on the maximum permitted period between the date of valuation and the listing of securities given the fact that real estate values can fluctuate. In our view 60 days is a reasonable maximum period particularly as the UK Listing Particulars currently provide 42 days.

- 5.7** Consideration may need to be given for a requirement to update the valuation where there is a material intervening event which impacts on value – for example an expected insolvency of a principal tenant.

Para 155 Q: “Do you agree with the proposed recommendations? If not, please state your reasons.”

- 5.8** We are broadly sympathetic to the CESR recommendations, subject to our preceding comments, as they are close to the existing UK regime.