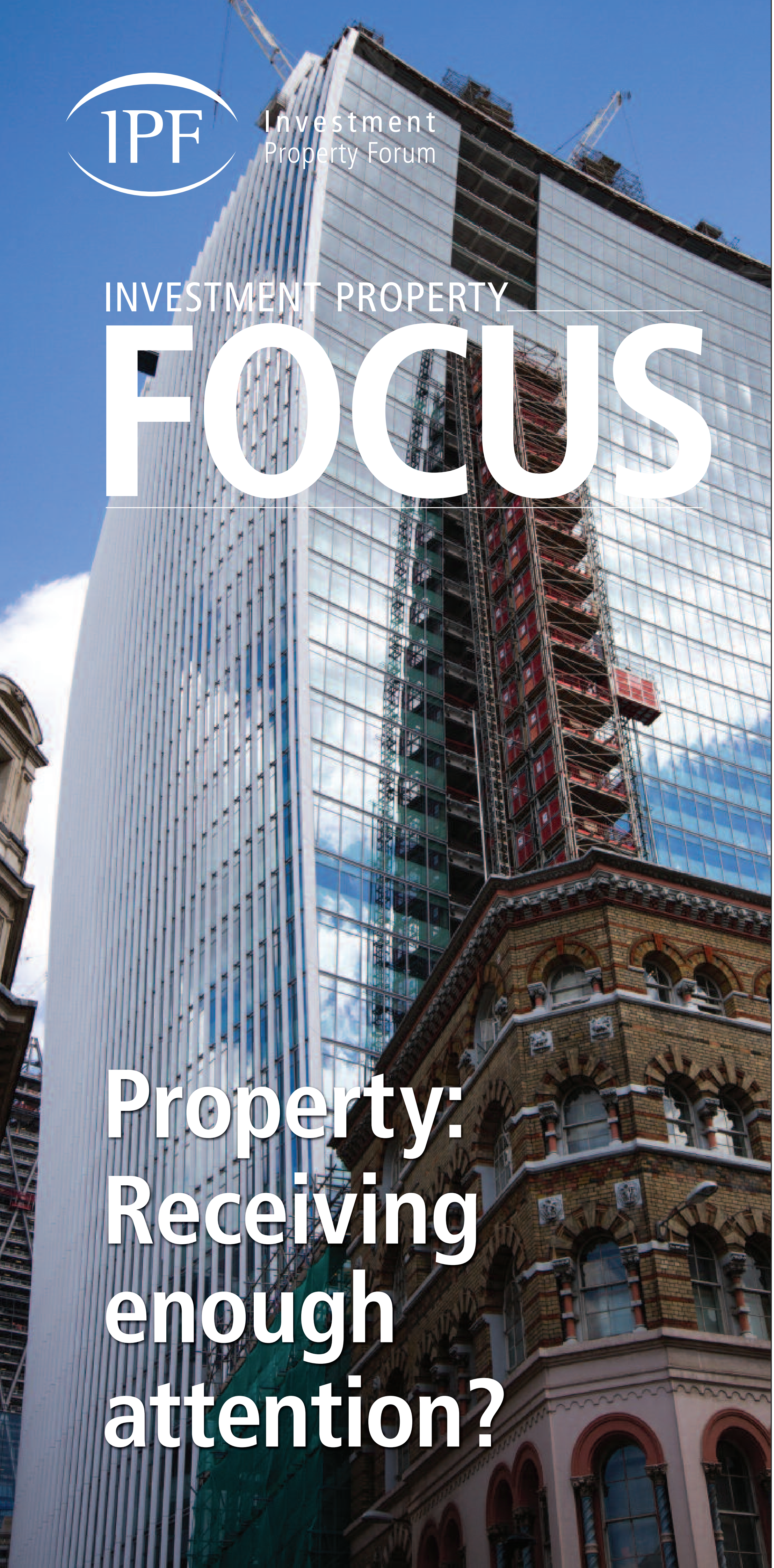
IPF Investment Property Forum

INVESTMENT PROPERTY FOCUS



Property: Receiving enough attention?

The Journal of the Investment Property Forum
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In this issue:

The joint venture partnership of Land Securities and Canary Wharf Group hosted two IPF site visits to 20 Fenchurch Street (the 'Walkie Talkie') in October 2012. Practical completion of the building is due in March 2014.

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From the editor

Sue Forster, Chief Executive, IPF

This bumper edition of Investment Property Focus marks the start of the IPF's 25th Anniversary year, during which both serious and more frivolous events and initiatives are planned. Presiding over this will be our new Chairman, Andrew Smith of Aberdeen Asset Management, who outlines his key priorities for the year on page 2. One of these is to increase the international scope of the IPF's activities in order to raise the organisation's profile and better equip members to compete in an increasingly global environment. On that theme, I interviewed Gareth Sellers of Jones Lang LaSalle and James Bauer of REAG about the valuation regimes in France and Germany respectively.

Of less significance (except to me!) is that this is my 10th anniversary as editor of Investment Property Focus, previously titled Forum View. The publication has grown substantially in length over the last decade and continues in its aim of providing a useful round-up of the Forum's activities and events, together with thought-provoking articles on topical issues.

As in previous years, we include an outline of the key findings of the De Montfort University research on the UK commercial property lending market. Bill Maxted and Trudi Porter of De Montford University highlight the fall of around 7% in the estimated total value of lending during 2012 but 72% of outstanding debt is due for repayment over the next five years – a high proportion compared with those recorded in the years leading up to the financial crisis.

Two articles by Matthew Abbott of Mercer and Dan Batterton of Legal & General Property look at the prospects for property funds. The former focuses on areas of fund governance that need to be addressed and the latter on whether unlisted funds are able to offer investors the liquidity they require.

The IPF has responded to a number of EU, UK Government and other public body consultations recently. The scale of the legal and regulatory proposals affecting the UK property investment sector is underlined by the increasing length of the round up, updated from last April, by Amanda Howard and Christine Ormond of Nabarro. More detailed updates on regulatory issues are provided by John Forbes of John Forbes Consulting (Solvency II) and Bill Gloyn of JLT Specialty (flood insurance), together with comparisons of English and Scottish carbon emission measures and SDLT vs. LBTT, the former by Alan Cook of Pinsent Masons and the latter by Iain Doran of Dundas & Wilson.

The importance of the property sector to the UK economy is considered in recent research published by the IPF Research Programme. The project team members, Neil Blake of CBRE and Tom Rogers of Oxford Economics, summarise the key findings – not least that there is a clear long-run relationship between economic activity and the net capital stock of commercial property. The Research Programme is also about to publish the results of the second survey of institutional investors as to their attitudes to investing in UK residential property. IPF Research Director, Pam Craddock found that interest in the sector is increasing measurably. One of the segments attracting growing interest is social housing and included in this edition of Focus is a summary of the seminar organised by the Residential Investment Special Interest Group on this subject.

Summaries of the IPF UK and European consensus forecasts for May 2013 are also included, together with an extensive overview of the Forum's activities. In particular, may I draw you attention to the proposed re-launch of the IPF's informal mentoring scheme.

We will be producing a 25th anniversary commemorative publication in November 2013, rather than Focus, but normal service resumes thereafter so if you would like to see coverage of a specific topic in Focus sometime during 2014, please contact me.

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Message from the Chairman

Andrew Smith, IPF Chairman

This year the IPF celebrates its 25th Anniversary. The growth of the Forum from small beginnings to the flourishing organisation of well over 2,000 members that we see today has been achieved in large measure through the commitment and engagement of many people who have served on boards, steering groups and working parties over the years.

Over its first quarter century, the Forum has been at the forefront of education and training for property investment professionals. Our research programme has developed a reputation for its quality and impartiality. Importantly, as the name suggests, it has also been a key networking forum, bringing together a community of people with different and complementary skills from across the industry: brokers, investors, lawyers, actuaries, fund managers, researchers, bankers, academics and many more. In this respect it is quite unique.

Despite the continuing economic uncertainties, the Forum's membership has now reached an all-time high, and over 100 more than this time last year. I am delighted to say that many of our new members have joined through the Next Generation Group that the IPF launched in November 2011, which augers well for the continuing health of the Forum for at least another 25 years! I congratulate the Next Generation Committee, the regional boards in the Midlands, the North and Scotland, and the main Membership Committee for their combined achievement.

Developing the Vision

Last year, my predecessor, Amanda Howard, emphasised the need to progress the five priorities identified in the IPF Vision, namely: to enhance the understanding of how property financed and funded; to identify and engage in debate over the effects of new legislation and regulation; to enhance the understanding of sustainability issues; to raise awareness of the increasing internationalisation of property; and to enhance the understanding of the residential property investment market. I am delighted to report that progress has been made on all fronts.

The IPF's capacity to develop and communicate new initiatives arising from the Vision has been enhanced by the appointment of Paul McNamara, a former chairman, as a part-time consultant in October 2012. He has been actively involved in a number of responses to government and other consultations, and is leading the on-going industry consultation on constructing an effective rental value index.

Thanks to the hard work of Amanda and our Chief Executive, Sue Forster, with considerable input from the Management Board, we now have the appropriate governance structure in place to provide future strategic direction and thought leadership. This new structure was approved at the Annual General Meeting on 20 June when changes to the articles of association mean the Forum can establish a separate Strategy Advisory Group and director-level Operational Board supporting more effective implementation.

Initiatives for 2013-14

Last year, we also undertook a survey of the membership to find out what you think of our current services and where you think the IPF should its focus attention in the future. In general, members said that they were happy with what the Forum is currently delivering but there were plenty of ideas as to what we should be doing to increase: our international credentials; engagement with other property industry bodies, government and other public bodies; provision of data on areas such as sustainability, residential investment and finance to the industry; and assistance to members, particularly those who are out of work.

I look forward to taking many of these initiatives forward. In particular, I should like to raise the IPF's international profile, to ensure that the excellent work from our Research Programme is more widely recognised, and to better equip our members to compete in an increasingly global marketplace. At the same time, I am keen to see that the Forum continues to offer a stimulating programme to our members across the UK, and will work with the regional boards to support this. Finally, I believe we are well placed to influence the long overdue emergence of residential property as a mainstream institutional investment sector in the UK.

We should not forget the Forum's key role in bringing together members and other industry players, both formally and informally. None of the seminars, workshops, research, education and social events would be possible without the many members who give of their time and effort, and the organisations who provide us with venues, not to mention the work of the Executive Team. I would like say a big thank you to everyone involved and I look forward to working with you over the course of the next 12 months.

I hope you will enjoy your participation in a variety of Forum events this year, not least our 25th anniversary celebrations, and invite any non-member readers to take up what is possibly the best value professional subscription in the market!

The UK commercial property lending market

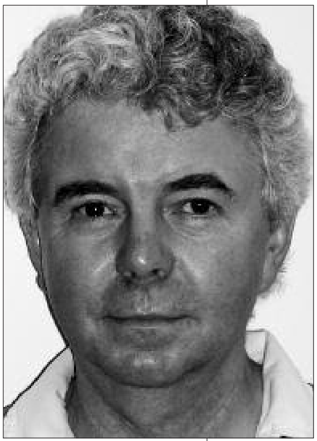
In May 2013, De Montfort University published its fourteenth research report on the lending patterns of the major commercial property lenders operating within the UK during the year up to 31 December 2012. A total of 87 lending teams operating out of 78 lending organisations contributed data to the survey and a further three organisations, that purchased non-performing loan portfolios secured against UK commercial property, contributed some information. A number of organisations have withdrawn completely from commercial property lending but they continue to report their value of outstanding debt and are included in the analysis.

During the first two quarters of 2011, the National Asset Management Agency (NAMA) completed the acquisitions of loans from five banks whose head offices are located in Ireland. The three largest of these banks have regularly contributed data to this research, and have continued to do so in respect of their UK operations. In this report, the data received from these organisations will exclude the value and details of loans transferred to NAMA that are secured by UK commercial property.

The rate and detail of response to individual questions varies between organisations due to reasons of confidentiality and availability of data. Thus, 100% response rate may refer to a different total from one question to another.

Throughout this research, 'commercial property lending' is taken to mean all lending secured on UK commercial property and held on the balance sheet of lending organisations. This includes residential investment and development but excludes owner occupier residential mortgages. Where reference is made to the commercial property loan books of lending organisations, this is taken as the net exposure to UK commercial property excluding equity finance (i.e. net of any loan amounts sold down to other lenders and net of any securitised loans unless otherwise stated).

The nationality of the banks is determined by the location of their head office. The term 'Insurance Companies' refers to all insurance companies irrespective of the geographic location of the head office and 'Other Non-bank Lenders' refers to debt funds and asset management companies that specialise in providing mainly mezzanine finance/junior debt and, in some instances provide senior debt as well.



Bill Maxted, Department of Corporate Development, De Montfort University

Value of outstanding loan books

A total value of £217.1bn (£232.7bn last year) of outstanding debt, including loans of approximately £19.1bn secured by social housing (but excluding equity participations) was recorded, with a further £15.2bn (£16bn at 31 December 2011) of loans being committed but not drawn at 31 December 2012.

Figure 1 presents the categories of lending organisations and their value of outstanding senior debt, junior/mezzanine finance and undrawn amounts.

Trudi Porter, Department of Corporate Development, De Montfort University

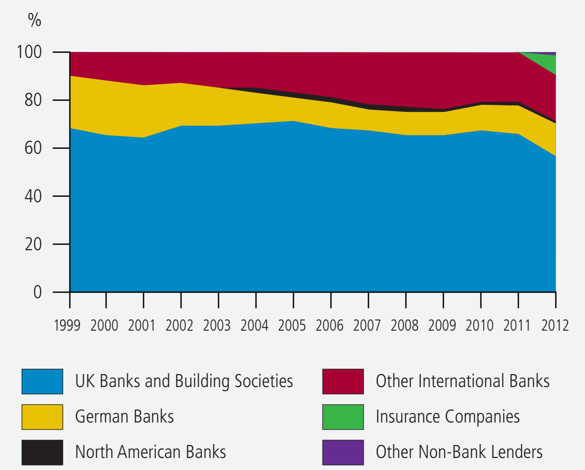
The aggregated value of outstanding debt recorded in loan books and secured only by UK commercial property, declined from £214.4bn at year-end 2011 to £197.9bn at year-end 2012 (see Figure 2). This represents a fall of 7.7%. Of this, £195.4bn is held by banks, building societies and insurance companies and £2.5bn held by Other Non-bank Lenders. Figure 3 shows outstanding debt secured by commercial property by category of lender over time.

Figure 1: Category of Lender and type of finance

Categories of Lender	Reported UK outstanding senior debt loans including social housing £m	Junior debt and mezzanine finance £m	Total £m	Reported amount of committed funds not yet drawn £m
UK Bank and Building Societies	130,203	1,296	131,499	12,415
German Banks	25,310	90	25,400	596
Other International Banks	39,125	300	39,425	1,296
North American Banks	2,178	5	2,183	585
Insurance Companies	15,798	252	16,050	229
Other Non-bank Lenders	1,118	1,403	2,521	–
All Lenders	**213,732**	**3,346**	**217,078**	**15,121**

Figure 2: Aggregated value of outstanding debt

Figure 3: Allocation of outstanding debt secured by commercial property by category of lender



As part of the process of widening the scope of this research to make it as comprehensive as possible, at year-end 2012, the following additional amounts of outstanding debt have been identified:

i. Approximately £20.6bn of debt, believed to be mainly secured by commercial property located in the UK but held by organisations that to date, have not participated in this research. This data has been obtained from the published financial statements of the organisations concerned. The organisations contained in this grouping include those that are running down their exposure to commercial property lending in the UK as well as those whose exposure is increasing in value. At year-end 2012, the £20.6bn identified has increased from £19.5bn similarly recorded at year-end 2011.

ii. An estimated £2.5bn of UK debt had, by year-end 2012, been sold by those organisations that had contributed data to this research. Whilst recorded at year-end 2012, it is unlikely that this research will be able to monitor, in detail, the future management and status of this debt.

iii. Fitch Ratings has provided data on the value of outstanding CMBS issuances that it has rated and that included loans secured by UK commercial property. At year-end 2012, this amounted to £27.4bn. Additionally, the total outstanding balance of UK CMBS was approximately £38bn at year-end 2012.

iv. The value of loans held by the NAMA that had acquired good (performing) and bad (non-performing) loans secured by all forms of real property from five financial institutions whose head offices are located in Ireland. By year-end 2011, NAMA had acquired loans with a face value of €74.2bn (approximately £62bn). Approximately £21.6bn relates to loans secured by property located in the UK and of this amount, 88% (circa £19bn), could be broadly described as commercial property assets. By March 2012, it is believed that this value had been reduced by disposals of loans and property assets to approximately £8.5bn.

Therefore at year-end 2012, an estimated total value of £267.5bn of outstanding debt secured by commercial property has been identified by this research. Excluding the value of loans held by NAMA, the total value reduces to £259bn, which is a reduction of around 7% on the comparable £277.5bn in 2011.

At year-end, those organisations that held recently-purchased, non-performing loan portfolios reported an aggregated total of £2.234bn as the outstanding unpaid principal balance of loans secured by UK commercial property. For the first time, the research included responses from such organisations.

Value of loan originations completed

Figure 4 shows the amount of new senior debt loan originations, junior debt/mezzanine finance and loan extensions completed during 2012 and secured by commercial property and social housing – the latter accounts for £1.3bn of the £25.7bn of new senior debt lending.

The analysis contained in the remainder of this article will exclude lending to social housing unless otherwise stated.

UK organisations (UK Banks and Building Societies) completed 48% of loan originations during 2012, German Banks 16% (26% in 2011), Other International Banks 15%, North American Banks 6%, Insurance Companies 10% and Other Non-bank Lenders 5%. Approximately 57% of the £25.4bn of new lending completed during 2012 was undertaken by just six organisations. Approximately 72% of loan originations completed during the whole of 2012 was undertaken by 12 organisations. This compares with 58% and 74% respectively, recorded at year-end 2011. The decline in proportion originated by the 'top 12'

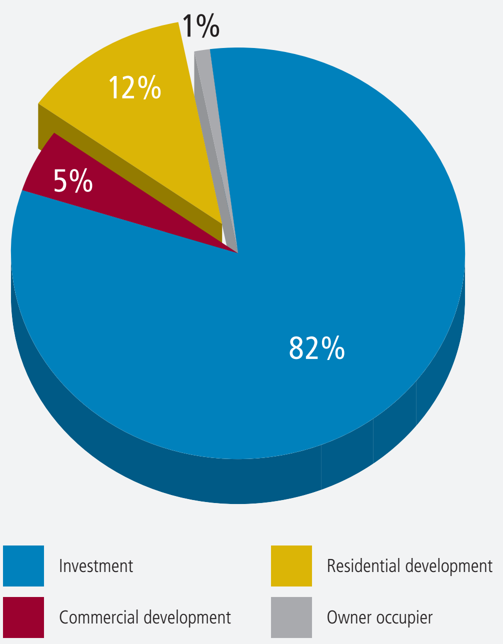
Figure 4: Value and allocation of loan originations in 2012

Categories of Lenders	Value of senior debt lending excluding extensions to maturing loans £m	Junior debt and mezzanine originated £m	Value of extensions to loans that should have matured during 2011 £m	Total £m
UK Banks and Building Societies	13,420	84	1,057	14,561
German Banks	3,952	–	471	4,423
Other International Banks	3,767	–	5,193	8,960
N. American Banks	1,575	–	48	1,623
Insurance Companies	2,528	30	271	2,829
Other Non-bank Lenders	501	827	–	1,328
All Lenders	**25,743**	**941**	**7,040**	**33,724**

organisations demonstrates the increasing influence of new lending organisations entering the market.

For the first time in the research, respondents were asked the proportional allocation by project type of new loans originated during the year. The responses shown in Figure 5 are for banks, building societies and insurance companies. By contrast, of the £1.3bn of loan originations undertaken by Other Non-bank Lenders, 91% was allocated to investment projects, 3% to commercial development and 6% to residential development.

Figure 5: Allocation of new lending by project type



Reductions in loan book during 2012

At year-end 2012, 54 of the 71 lending teams from banks, building societies and insurance companies (not including Non-bank Lenders) identified a reduction and these held 76% of outstanding debt recorded at year-end 2012. Collectively they identified a reduction of £30.6bn.

Some 39% of reductions were due to the scheduled repayment and amortisation of loans. This is similar to the 40% being recorded at year-end 2011. Customers paying down, 26% and Bank/lending organisation influenced sales, 20%, record increased proportions compared to 21% and 17% respectively recorded at year-end 2011. The most significant variation in data between mid-year 2012 and year-end 2012 is in the proportion of loans being sold. On a pro-rata basis, just 1% of the reduction at mid-year 2012, representing approximately 0.2bn, was recorded as being due to loan sales. By year-end 2012 this had increased to 8% representing approximately £2.5bn.

Securitisations, syndications and club deals

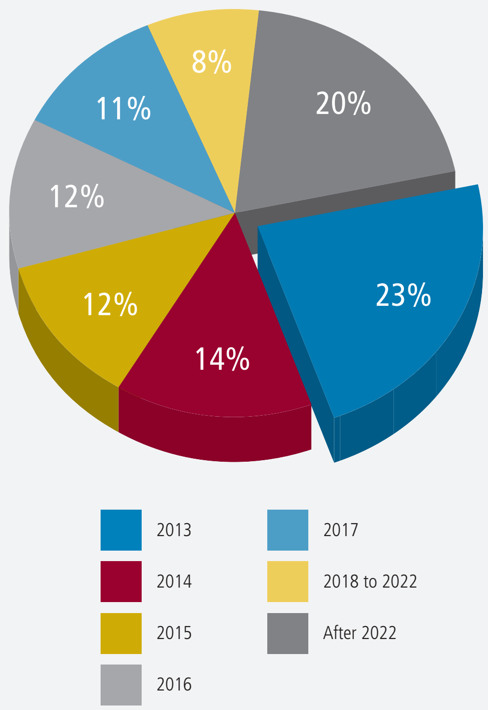
A single issue of £210m of debt was reported as being securitised during the first half of 2012. Approximately £2.0bn of debt was reported as being syndicated and a further £4.5bn as the value of participations in club deals by organisations that contribute to this research. This total of £6.5bn compares with £6.9bn similarly reported at year-end 2011.

Debt repayment

Figure 6 shows the proportion of outstanding debt due for repayment in each of the next five years individually from 2013 to 2017, from 2018 to 2022 and finally after 2022.

Over the next five years approximately 72% of all outstanding debt (£143bn) is due for repayment. This proportion is identical to that reported at year-end 2011 over the same time period and still significantly higher than the proportions recorded several

Figure 6: Proportion of debt due for repayment: All lenders



years ago, e.g. in 2006 and 2007, the proportion was 61% and 60% respectively. This change shows that lending organisations that have legacy debt in their outstanding loan books continue to extend performing loans that the borrowers have been unable to refinance at loan maturity.

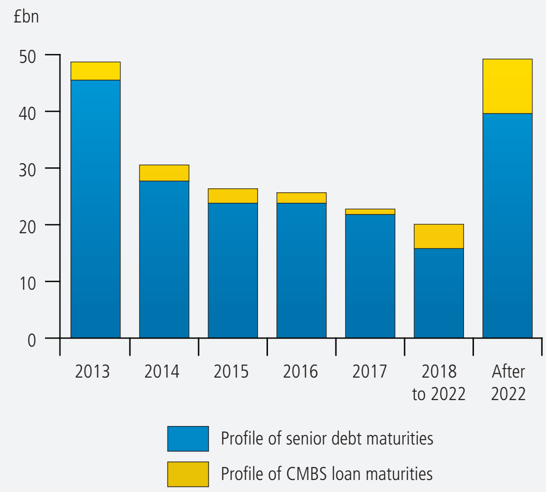
Figure 7 profiles the amount of senior debt due to mature, together with the maturing loans in the CMBS market.

Figure 8 presents the approximate proportion of the outstanding debt that had a current loan-to-value ratio falling within the brackets given (and ignoring swap breakage costs). Responses were received from organisations holding approximately £170bn of outstanding debt.

As demonstrated, 53% of the outstanding debt had a loan-to-value ratio of 70% or less. This equated to approximately £103.6bn. The proportion of outstanding debt with a loan-to-value ratio of between 71% and 100% was 24%, representing a value of approximately £47bn. The proportion of loans above 100% loan-to-value increased to 23% (20% in 2011), representing a value of £45bn.

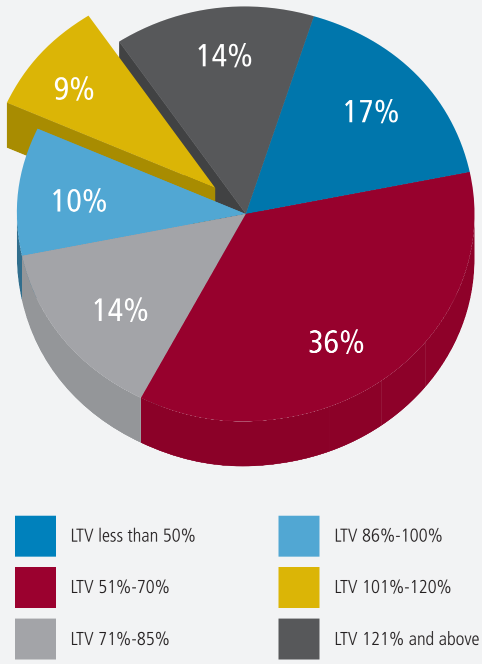
Banks, building societies and insurance companies were asked to consider the proportion of outstanding debt that had a current income to interest cover falling in specific brackets. At year-end, 38 lending teams (52%) provided information. The results are shown in Figure 9.

Figure 7: Profile of balance sheet debt and CMBS loan maturities



Source: Fitch Ratings and De Montfort University

Figure 8: Current loan-to-value ratios by proportion of outstanding debt



At year-end 2012, typical income-to-interest cover ratios required for loans secured by all property sectors were recorded at 1.6x and above. This suggests that at year-end 2012 up to 65% of outstanding debt had an income-to-interest cover below that which was required for new loan originations in the market at that time.

Figure 9: Current income-to-interest cover by proportion of outstanding debt

Level of cover	Variable rate % proportion of loan book		Fixed rate % proportion of loan book	
	2012 Mid-year	2012 Year-end	2012 Mid-year	2012 Year-end
1x or less	7.0	4.5	4.0	12.5
Over 1 and up to 1.2x	5.0	3.0	11.0	14.0
Over 1.2 and up to 1.4x	8.5	3.0	6.0	8.0
Over 1.4 and up to 1.6x	4.5	5.0	5.0	18.0
Over 1.6 and up to 1.8x	3.0	2.0	4.0	4.0
Over 1.8 and up to 2x	3.0	2.5	3.0	2.5
Over 2x	21.0	13.0	15.0	8.0
Total	**52.0**	**33.0**	**48.0**	**67.0**

Loan terms

Typical loan lengths

During 2012, 74% of all investment loans were written for a period of between four to seven years and 18% for a period of up to three years. Thus, 94% of all loans were written for a period up to seven years. This compares with 96% in 2011, 90% in 2010, 88% in 2009, 84% in 2008 and 77% in 2007. There has, therefore, been a shift to shorter loan lengths during 2011 and 2012.

The typical average length of loans secured by investment properties in 2012 was recorded at 5.6 years. This is an increase from 5.5 years recorded at year-end 2011, 5.4 years at year-end 2012 and 4.7 years recorded in both 2009 and 2008. This increase is influenced by the length of loan required by a number of the insurance companies, that contribute to this research and which are 5-19 years duration. The most frequently cited length of investment loan at year-end 2012 was five years.

For investment loans maturing in 2012, the range in length of extended loans was from six months to four years. This compares with a range of six months to three years at year-end 2011, six months to ten years at year-end 2009. The most frequently cited length was one year, with the average for all respondents being two years. The range in length of loan extensions has declined during 2011 and 2012, which is believed to be the result of regulatory capital requirements.

For development loans, 44% of loans were written for a period of two years or less. Nearly a quarter were for a period of 2 to 3 years and 33% for a period in excess of 3 years. It is believed that the responses are strongly influenced by much of the development finance available during 2012 being for new residential development primarily located in the South East.

It was commonly cited by respondents that together with the costs for funds and regulatory capital requirements, the quality and reliability of the borrower continued to be key factors in the decision of whether or not to extend maturing loans and the length of extension to give.

Average interest rate margins

Between mid-year and year-end 2012, interest rate margins declined for all sectors. This was the first decline in interest rate margins since year-end 2006. The average margin for loans secured by prime office, for example, declined from 335.1bps recorded at mid-year 2012 to 323.8bps recorded at year-end. Loans secured by secondary offices, average interest rate margins declined more modestly from 386.9bps recorded at mid-year 2012 to 384.5bps at year-end. Thus, the decline in margins for loans secured by secondary offices was not as pronounced as that for prime. The difference between the average interest rate margin for prime offices and that for secondary stood at 60.7bps, the largest gap recorded by this research.

For fully pre-let office development projects, interest rate margins increased from 374bps at year-end 2011 to 422bps recorded both at mid-year and year-end 2012. For 50% pre-let and 50% speculative office development projects, interest rate margins increased from 419bps at year-end 2011 to 461bps at mid-year 2012 and then to 471bps at year-end 2012.

At year-end 2012 and for the second consecutive year, no contributor provided senior debt loan terms to the research for speculative office development.

Average loan-to-value ratios

Between year-end 2010 and year-end 2011, the average loan-to-value ratio for all sectors fell to the lowest levels recorded by this research. They then stabilised largely for loans secured by prime offices and prime retail property and increased for loans secured by prime industrial property. For example, the average loan-to-value ratio for loans secured by prime offices was recorded at 64.3% at year-end 2011 and 64.2% at year-end 2012.

Average arrangement fees

During the first half of 2012, average arrangement fees increased for loans secured by all property sectors but in the second half of 2012 the trend varied considerably. Arrangement fees increased modestly for loans secured by prime office and retail property from 120bps (office) and 118.3bps (retail) at mid-year 2012 to 122.5bps (office) and 118.6bps (retail) at year end. For loans secured by prime industrial property arrangement fees increased from 115.7bps at year-end 2011 to 128bps at mid-year 2012 and then fell to 125bps at year-end 2012.

For loans secured by secondary office property, arrangement fees increased from 120bps recorded at year-end 2011, to 134.7bps at mid-year 2012 and remained at this level at year-end 2012. Conversely, loans secured by secondary retail property, saw arrangement fees increased form 123.9bps at year-end 2011 to 133.6bps by mid-year 2012 and then declined to 130.2bps by year end. A continuous increase in fees was recorded for loans secured by secondary industrial property. These were recorded at 116.6bps at year-end 2011, 127.2bps at mid-year 2012 and 133.2bps at year-end.

For loans secured by residential investment property, these increased form 120.6bps at year-end 2011 to 129.5bps at mid-year 2012 and the fell sharply to 118.2bps at year-end.

Average income to interest cover

During 2012, base rates remained unchanged, swap rates trended down throughout the year to historic low levels and prime property yields recorded a small decline by year-end.

For loans secured by prime property, income-to-interest cover ratios increased slightly during the first half of 2012 (for example 1.60x at year-end 2011 to 1.63x at mid-year 2012) and then declined during the second half of 2012 (1.59x for offices at year-end 2012). The exception to this general trend is for loans secured by prime industrial property which increased from 1.71x at year-end 2011 to 1.73x at year-end 2012.

For loans secured by office and retail secondary property, the income-to-interest cover ratios showed little or no variation between year-ends 2011 and 2012 at 1.89x and 1.86x respectively. This is despite fluctuations during the year. Income-to-interest cover for loans secured by secondary industrial property were recorded at 2.08x at year-end 2011, 2.10x at mid-year 2012 and 2.05x at year end 2012. Income-to-interest cover ratios for loans secured by residential investment property declined throughout 2012 from 1.71x recorded at year-end 2011, to 1.56x recorded at year-end 2012.

Loans above £100m

The research at year-end 2012 identified nineteen organisations that would be prepared to provide loans of a value of £100m and above. Nine (47%) of these organisations indicated that they would vary the loan terms given above – these included increasing the interest rate margin, increasing the margin and increasing the arrangement fee, or, an increase in arrangement fee. Increases in interest rate margin ranged from 'slight increase' to 50bps and increases in arrangement fee ranged from 10bps to 200bps.

In addition, three organisations stated that they would consider loans of this magnitude if they were part of a syndicate or club. Typically a 'hold' value would be in the region of £50m to £60m. In these situations there is likely to be an unspecified increase in arrangement fees to cover the costs of the additional administration involved.

Junior debt and mezzanine finance for investment loans

Figure 10 presents the average maximum loan-to-value thresholds between senior debt, junior debt and mezzanine finance for a prime office investment, together with the average interest rate margin applied to each. At year-end 2012, just four organisations were prepared to provide finance above a senior debt level. This is the same number that provided data at year-ends 2010 and 2011 and compares with nine that did so at year-end 2009.

The average loan-to-value ratio has increased for senior debt and mezzanine finance between 2011 and 2012, but decreased for junior debt. All four respondents reported the same maximum loan-to-value ratio of 65% for senior debt and 70% for junior debt. There was a range of between 75% and 80% for mezzanine finance. Interest rate margins declined during 2012 and ranged between 275bps to 400bps for senior debt, 500bps to 700bps for junior debt and 500bps to 1050bps for mezzanine. Required Internal Rates of Return ranged from 8% to 10% for junior debt and 12% to 15% for mezzanine finance.

Figure 10: Comparison of senior debt, junior debt and mezzanine terms on loans secured by prime office investment property (banks, building societies and insurance iompanies)

Year end	Senior debt		Junior debt		Mezzanine	
	Max LTV%	Margin bps	Max LTV%	Margin bps	Max LTV%	Margin bps
2008	55	170	60	250	70	400
2009	65	224	72.5	620	79	850
2010	67.5	209	75	350	80	738
2011	64	350	78	1050	75	1000
2012	65	331	70	550	77.5	775

Hedging strategy

At 2012 year-end, organisations holding approximately 77% of the outstanding debt of £195.4bn responded to this part of the survey. Collectively they reported that 61% of the debt that they held had interest rate hedging in place at year-end.

With regard to new loans written during 2012, 65% of organisations always require an agreed interest rate hedging strategy to be in place. This proportion is a decline from the 73% reported as doing so at year-end 2011, the 77% reported at year-end 2010 and the 85% reported at the end of 2009. Of the remainder, at year end 2012, 12% only 'sometimes' require a hedging strategy to be in place whilst 23% do not require a strategy to be in place at all. Those that answered 'no' commented that, in the current environment of low interest rates a dialogue would be maintained with the borrower so that a strategy could be put in place if necessary. However, the decision to 'hedge' would ultimately be left to the borrower. Organisations also commented that hedging would not be required if the loan was for a short term, for example, under three years.

At year-end 2012, respondents identified that 76% (65% at year-end 2011) of the hedging is fixed and the remaining 24% (35% at year-end 2011) was by way of another instrument, for example, an interest rate cap.

Loans in breach of financial covenant and defaulted loans

'In breach of financial covenant' is defined in the survey as meaning loans where interest and/or principal repayments have been wholly or partly unpaid and/or the loan-to-value ratio or other covenants have been breached but the loan has not been declared in default. A default is defined as meaning loans where the borrower has breached its loan obligations and the lending organisation has decided to accelerate the loan.

At year-end 2012, 61% of the whole sample of banks, building societies and insurance companies (holding 86% of outstanding debt of £195.4bn) responded that they held loans that were in breach of financial covenant. Twenty-two percent of the sample (holding 6% of the outstanding debt) reported that they did not hold any loans that were in breach of financial covenant. The data for this latter group is strongly influenced by organisations that have recently entered the market, organisations that exited the market at the start of the financial crisis and recently re-entered the market with a 'clean book', organisations that have recently joined the research and lent consistently and selectively in the UK market throughout the period of the financial crisis, and, niche lenders that specialise in, for example, loans for residential development

Figure 11 presents the number and value of loans in breach of financial covenant that have been reported to the research at each year-end from 2005 to 2012. If the proportion in 2012 of 11% is applied to the value of debt held by those organisations not responding to this section of the research, this suggests that, approximately, another £1.7bn of debt could be in breach of financial covenant giving £21.6bn in total.

Figure 11: Number and value of loans in breach of financial covenant

Year end	Number of loans in breach	Value of loans in breach £m	Value of loans as % of aggregated loan books
2005	689	1,225	< 1.0
2006	1,928	4,234	2.5
2007	1,051	1,597	< 1.0
2008	3,770	10,695	6.5
2009	3,665	28,305	15.5
2010	7,733	21,975	12.0
2011	8,366	22,821	12.0
2012	7,282	19,930	11.0

The reduction in both the number and value of loans reported as being in breach of financial covenant compared with year-end 2011 is believed to be a consequence of lending organisations reducing their value of outstanding debt by a variety of measures. Also, it is believed that a proportion of loans previously reported to be in breach have, by year-end 2012, been declared and recorded as in default.

The data between year-ends 2011 and 2012 is not significantly different with 'combination' of covenant breaches and 'loan-to-value' covenant breaches being the predominant reasons for breaches to occur. However, this does not capture the situation at mid-year 2012 when there was recorded higher proportions of 'interest being wholly or partly unpaid' (17%) and principal wholly or partly unpaid' (12%). It is believed that weakening income streams, that have become more prominent in this data since mid-year 2011, resulted after mid-year 2012, in further declines in capital values. Breaches in income and debt service covenants have been occurring and the loss of income contributed to further declines in capital value. Thus, at year-end 2012 respondents reported further breaches in loan-to-value ratios (LTV covenant breach) caused by a reduction in cash flow (combination breach).

With regards to loans that actually defaulted, 42% of the sample of banks, building societies and insurance companies (holding 79% of the outstanding debt of £195.4bn) reported that they had taken action to accelerate repayments. Thirty-eight percent reported that they had not taken such action (holding 13% of the outstanding debt). Organisations holding 9% of the outstanding debt of £195.4bn did not respond to this section of the questionnaire.

The aggregated responses are presented in Figure 12 for year-ends 2008 to 2012.

Figure 12: Defaulted loans – All lenders

	Number of loans defaulted	Value by principal outstanding £m	Amount of provision made £m
2008 year-end	3,230	3,134	1,174
2009 year-end	6,537	19,333	8,252
2010 year-end	6,402	15,376	8,642
2011 year-end	8,940	19,631	7,420
2012 year-end	10,859	21,503	6,820

The value of defaulted loans of approximately £21.5bn represents 12% of the aggregated loan book of those organisations that reported to this aspect of the research. If this proportion is applied to the total value of outstanding debt of £195.4bn recorded at year-end 2012, then approximately £23.6bn of loans may have been in default at year-end 2012.

With regard to the reasons for loans to be declared in breach of financial covenant or default, the general downturn in the UK economy leading to an overall reduction in demand in the commercial property sector continues to be the major cause. Respondents reported to the research an increase in tenant defaults that have caused a decline in rental income. This results in an increase in holding and management costs and in many instances makes it unviable to service the loan. In turn, this also results in a decline in the capital value of the property. These two factors acting together have been a major contributor to an increase in overall defaults. Market conditions have failed to improve resulting in a reduced ability to sell properties and prolonged voids on empty properties. Lenders have experienced the 'walk away' factor as borrowers' equity or recourse support has run out.

The market for secondary properties was highlighted as a major cause for concern with retail and hospitality/leisure being reported as sectors experiencing the greatest problems. Geographically, the North East and East Anglia were reported as regions where the commercial property market was particularly difficult.

In relation to development, lenders reported pre-let commercial development schemes remaining empty because of incoming tenants' business failure and borrowers being unable to let the completed developments. Also, declines in the final gross development value resulting in the asset cover shortfalls and the inability to service the debt from the alternative of letting the completed development, was another significant problem area. Lenders also reported contractor failures and the difficulty of getting development completed, particularly in the residential sector, as another problem area. In these circumstances lenders have put their own money into these schemes to complete.

Overall lenders were reporting a reduction in the year-on-year number of new impaired loans. However, the situation with many existing problem loans was deteriorating – in many cases the lenders had reached the point where they are selling the properties securing non-performing loans. In these circumstances, the decision is driven by regulatory pressure and the additional capital costs involved in continuing to hold these assets. In contrast, in situations where there is still value in the asset, lenders commented that they do not necessarily like to enforce. Instead, it is preferable to work with the borrower. This approach saves money by not having to appoint administrators and receivers that will be less familiar with the asset than the borrower. Also by restructuring the loan and keeping 'triggers' in place the lender can bring the borrower back to the 'table' whenever it is necessary.

Similar to mid-year 2012, organisations commented that generally a harder stance was being taken with problem loans.

Structure of outstanding loan books

Type of project

The proportion of outstanding debt allocated to investment property which had been declining between 2003 and 2007, increased between 2008 and 2011. At year-end 2012, the proportion fell back slightly from 81.5% to 81%. There was a more substantial fall in the proportion of the aggregated loan book allocated to development, from 11% recorded at year-end 2011 to 9.5% a year later. Commercial property development declined from 4% at year-end 2011, to 3.5% at year-end 2012, equating to £7.1bn. The value of debt, outstanding and secured by residential development projects for sale stands at £12.4bn. This is the fourth consecutive year that a fall in the allocation of loan books to residential development has been recorded.

Type of property

Comparing the results for 2012 with those of 2011, there has been small changes to specific sectors of loan book allocations. Retail (22.5), Office and Business Parks (28%), and Social Housing (10.0%) have experienced increases in loan book allocations. In contrast, Residential (11.5%), Hotels and Leisure (4.5%) and 'Other' (12%) have experienced decreases in loan book allocations. The classification of Industrial (10.0%) and Distribution and Warehouses (1.5%) have stayed the same. The 'Other' classification includes mixed commercial projects, car parks, health care, student housing, nursing homes and 'owner occupied'.

Borrower type

The responses from banks, building societies and insurance companies show a decrease to the allocation of lending to High Net Worth Individuals, Family Trusts, or Privately Owned Property Companies was recorded. This allocation fell from 74% recorded at year-end 2011, to 65% at year-end 2012. This is balanced by recorded increases from 8% to 10% allocated to Institutional Investors, from 10% to 13% allocated to Private Equity Investors and from 1% to 4% allocated to 'Other'. This category includes social housing and private pension trusts. The allocation to Publicly Quoted Property Companies remained at 8%.

Regional allocation

According to the responses from the banks, building societies and insurance companies, there is a concentration of 47.5% of outstanding debt allocated to London and the South East. This compares with 46.5% at year-end 2011, 44% at year-end 2010, 45% at year-end 2009 and 52% at year-end 2009. Loan book allocations to Central London have increased from 26% at year-end 2010 to 29.5% recorded at both year-ends 2011 and 2012. Anecdotal evidence contained in the comments (see Appendix J) suggests that this is a policy of many organisations to concentrate their commercial property lending, if possible, in London and the South East.

International lending

At year-end 2012, for banks, building societies and insurance companies, £17.1bn of outstanding debt was reported as having been historically originated by lending teams based in the UK but secured by commercial property situated outside of the UK. This figure is a decline of 18% from the comparable figure recorded for year-end 2011 of £20.9bn.

Lending intentions

Figure 13 shows banks, building societies and insurance companies' future lending intentions over the next 12 months from the date of the survey. This part of the questionnaire is analysed on the basis of lending teams and not organisations as, in a small number of large organisations, responses are received from several lending teams. Different lending policies can exist within a single organisation.

Figure 13: Future lending intentions: loan book size and originations

Year-end	Intention to increase loan book size %	Intention to increase loan originations %
2008	24	23
2009	49	56
2010	46	57
2011	38	44
2012	46	54

The proportion of lending teams looking to increase the size of their loan book has increased during 2012, with 46% indicating this intention. In contrast 41% of lending teams have the intention of reducing the size of their loan book. This group includes those organisations that have withdrawn from the commercial property lending market in the UK but continue to contribute data to the research.

Overall, 54% of lending teams stated an intention to increase loan originations during the next 12 months. This is an increase from 46% recorded at year-end 2011. This group is influenced by new organisations entering the market during 2012. Those lending teams intending to increase loan originations were responsible for £19.2bn (80%) of all new loan originations reported during 2012. Those teams intending to maintain loan originations (22.5%) were responsible for £3.9bn (16%) of all new loan originations. At year-end 2012, 23.5% of teams either intended to reduce their volume of loan originations or had withdrawn from the market.

All categories of lending teams, apart from German Lenders, recorded an increase in intentions to originate new lending at year-end 2012, but proportionately, UK Lenders and Building Societies recorded the weakest intentions.

All of Other Non-bank Lenders intended to increase loan originations and loan book sizes.

Figure 14: Lending intentions

	Yes %	No %	Not answered %
Do you still see commercial property as an asset class against which your organisation is willing to lend?	71	25	4
Did you alter your level of pricing during the last two quarters of 2012?	42	28	30
	Increase %	**Decrease %**	**Maintained %**
If yes, what was the nature of the alteration?	57	43	n/a
In what way do you see your level of pricing as at year-end 2012 altering during the first 6 months of 2013?	14	30	57

Opinions on property

The research for 2012 asked banks, building societies and insurance companies to answer four specific questions that related to their lending activity/intentions during the reporting period and the six months following. The questions and summary of the responses are shown in Figure 14.

This demonstrates that despite the current difficulties being experienced in the market, at year-end 2012, 71% of organisations continue to regard UK commercial property as an asset class against which they are willing to lend

Key conclusions

At year-end 2012 the UK commercial property lending market exhibited a number of contrasting features, as summarised below.

The aggregated loan book is being reduced gradually and the reduction in outstanding debt with a loan-to-value ratio of between 71% and 100% suggests that banks are resolving issues with legacy debt positions, especially where the transactions still have value. However, the amount of legacy debt with a loan-to-value ratio above 100% increased in absolute terms to £45bn at year-end 2012 from £42bn recorded at year-end 2011. Thus, there are substantial legacy issues that still remain unresolved.

The continued absence of sustainable growth and confidence in the UK economy is regarded as a major impediment to the improvement in the commercial property market generally. Declines in the capital value of secondary and tertiary property that were experienced during 2012 will, therefore, have made lending to non-prime regional properties more difficult. Lenders commented on the lack of senior debt finance available for deal sizes of between £10m and £30m, which is typically the range within which many regional transactions are positioned.

Lenders continue to report that the emerging regulatory environment will restrict opportunities by directing commercial property lending to transactions involving prime property at modest loan-to-value ratios.

It was believed that the problems of the Eurozone, whilst having 'gone quiet' towards the end of 2012, could quickly come to the fore again as the situation in Cyprus demonstrated at the beginning of 2013.

Recent market entrants are becoming active lenders but their lending appetite remains selective and shows a clear bias towards central London and investment projects. It appears, therefore, that these organisations are unlikely to offer major solutions to the lack of lending to commercial development projects and in the regions generally. However, if over the longer term, they provide enough new money to force margins down for the best deals, will this encourage yield-hungry investors to broaden their lending criteria to the regions and to development? Unless this happens, then the polarisation in the market will continue. If the lending criteria are subsequently broadened, will this herald a turning point in the market?

The role of commercial property in the UK economy

Neil Blake, CBRE

Tom Rogers, Oxford Economics

This article summarises the recent research, commissioned by the IPF Research Programme, to place commercial property in the context of the wider UK economy and to explore the nature of the links between the two.

The research looks at:

- The direct role the sector plays in employment, output generation and tax take. Additionally, the impact of the downturn on the commercial property sector is considered in terms of the depth of the downturn in the sector relative to its long-run trend within the wider economy; and
- The role of property as a factor of production. In particular, the research considers the long-run relationship between the net stock of commercial property, the level of economic output and the rate at which new construction needs to take place to ensure that the sector can continue to play its role in facilitating economic activity in the rest of the economy.

Approach to the research

Due to data constraints, the definition of the commercial property sector used comprises construction of commercial property (sometimes referred to as 'new build'), repair and maintenance (R&M) of existing commercial property and real estate activity related to commercial property.

In contrast to previous work, this analysis separates out the economic impact of commercial property sector activity from the role of commercial property as a factor of production. As such, imputed rents of owner-occupied property are not included in the estimates of economic impact, given that these reflect the utility gained by users of commercial property, rather than the gross value added (GVA), jobs and tax impact of the activity in the commercial property sector itself. A corollary with another industry would be to estimate the impact of the automotive sector purely through the jobs and output it generates through its own activity and those firms that supply it. This would not add the GVA generated through the activities of hire car companies or the payments made by consumers on car financing packages, since these represent activity of car users, not car makers.

The direct role of property in the UK economy

Direct economic impacts

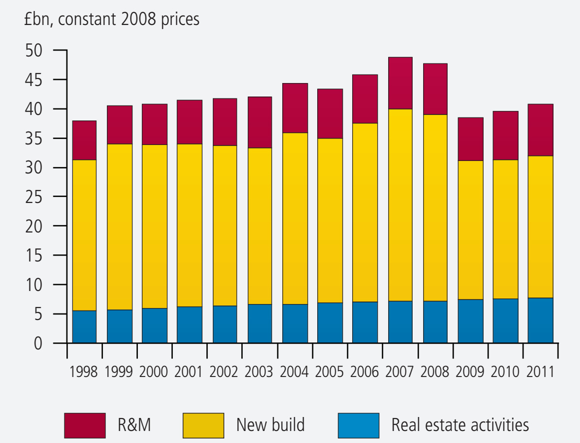
The estimates, set out in Figure 1, indicate that total GVA across construction (new build and R&M) and other real estate activities totalled around £41bn in constant 2008 prices in 2011 (3.2% of 2008 prices UK GVA), down from just under £49bn in 2007 (3.8%). The fall of 16% in real commercial property output is a much greater contraction than output across the economy as a whole, which was around 3% lower in 2011 than in 2007. This illustrates the role that the sector plays in facilitating investment by firms, which typically falls much faster during a recession than overall output. The fall in commercial property GVA from 2007-2011 is broadly in line with that of wider business investment, which in 2011 was 14% lower in constant prices than in 2007.

The estimates of employment in different parts of the commercial property sector are based on the respective shares of commercial property new build and R&M in total construction output, and the total level of construction employment in the UK. Employment in the real estate sector is apportioned to commercial property based on the authors' estimates of the share of GVA in the sector.

These estimates show total employment in these three parts of the commercial property sector (including both employees and the self-employed) to have been 797,000 in 2010, or 2.5% of total workforce jobs. To this may be added approximately 15,000 jobs in fund investment and asset management identified in the PIA Property Data Report 2011. Employment in the sector has since edged down a little further, to 781,000.

Based on these estimates, the commercial property sector has shed 259,000 jobs since the start of the recession in 2008, when the total employed was 1.04m. The vast majority of these, 230,000, have been in new build construction, with 10,000 jobs or so lost in each of the R&M and real estate services sub-sectors. This loss of employment has had a significant impact on the state of the overall UK labour market. The loss is equivalent to just under half of the total decline in employment at the UK level over the same period (total workforce jobs in the UK were 31.8m in 2007

Figure 1: Components of GVA in commercial property



Source: Oxford Economics, Haver Analytics and 31.2m in 2011). Other sectors, however, have also lost significant numbers of jobs over the same period – employment in the manufacturing sector is 300,000 lower, for example.

Had the sector suffered a more moderate correction, back to its long-run trend relative to the wider economy, it is estimated that employment in the commercial property sector would be approximately 80,000 higher than it is currently.

Tax impacts

Data for the sectoral breakdown of tax contributions are most readily available for VAT and PAYE. There are also good data on the rateable value of property by types of premises. Ideally this analysis would also be repeated for the sector's contribution through corporation tax but the data does not allow for sufficiently detailed analysis to determine this.

Using the share of commercial property new build and R&M in total construction GVA and latest data for the value of VAT payments made by the construction sector as a whole, an estimate for net VAT payments by the construction parts of the commercial property sector yields just under £2.1bn in net VAT payments in 2009-10. A similar methodology for the real estate portion produces a figure of £1.87bn in 2009-10. This total of £3.9bn is equivalent to 4.1% of the total VAT paid in the UK economy, noticeably higher than commercial property's share of current price GVA in 2010 (around 3%).

The estimates of PAYE generated by commercial property assume that output per worker in the commercial property construction and real estate sector is the same as in the wider construction and real estate sector. Taking into account the two construction sub-sectors and commercial property real estate services, the total PAYE revenue in 2009-10 was over £2.5bn. In contrast to the VAT contribution of commercial property, which has held up relatively well during the downturn, PAYE generated by the sector has declined substantially, from just short of £4bn in 2007-08. In proportionate terms, the commercial property sector contributed 2.1% of total PAYE in 2009-10, down from 3.1% in 2007-08.

Commercial property, on a narrowly defined basis (including retail, industrial and office space), contributes just under 50% of the total rateable value of all real estate in England and Wales. Incorporating other types of property that could be considered part of the commercial estate, including licensed premises and entertainment venues, increases this proportion to nearly two-thirds of all rateable values (around £31bn out of a total £51.3bn rateable value). Business rates contribution is estimated at around £25bn in 2011-12.

In terms of SDLT, commercial property contributed around £2.5bn per annum prior to the crisis, but this fell markedly in 2008-09 and 2009-10, as investment market activity reduced significantly. Receipts from SDLT in commercial property have rebounded subsequently to circa £1.6bn, but remain around 30-40% lower than prior to the economic crisis.

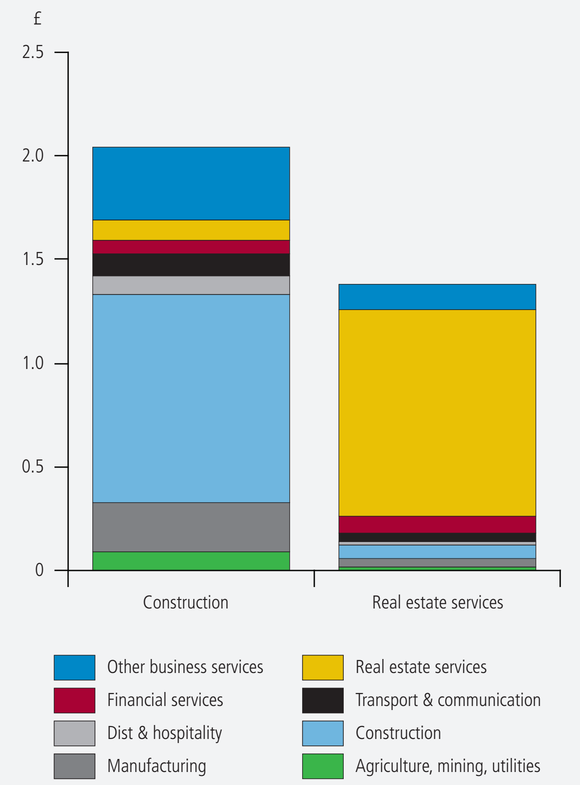
The total tax contribution by the sector is therefore in the order of £33bn, excluding tax generated by the sector's multiplier effect in the rest of the economy, as outlined below.

Indirect economic impacts

Figure 2 shows the estimated total value added across sectors associated with a £1 increase in value added in commercial property construction (based on the all-sector construction data) and real estate services. These are estimated by manipulating the ONS input-output tables (the 2005 Domestic Use Table). The estimates take into account supply chain and consumer spending multipliers and leakages from the economy due to savings, taxation and imports. Consumer spending on real estate has been modified to exclude the imputed rent of owner-occupiers. The industries benefiting most from an increase in commercial property real estate services are financial services, business services and construction, although these effects are somewhat smaller than in the case of construction.

The analysis suggests that a rise or fall of £1 in the value added of commercial construction is associated with the equivalent rise or fall in value added for the economy as a whole of £2.09, and

Figure 2: Total value added associated with a £1 increase in commercial property construction or real estate value added



Source: Oxford Economics

the equivalent figure for 'real estate services' is £1.42. For comparison, the equivalent figure averaged across all sectors is £1.94. This implies that the fall in commercial property GVA from 2008 to 2011 (approximately £8bn) was associated with a wider loss of GVA of around £17bn.

The economic crisis and commercial property

Commercial property has suffered more than the economy as a whole during the downturn, given the cyclicality of business investment and reduced spending on new premises. Output in constant prices fell by around £9bn from 2007 to 2011.

Had GVA in the sector evolved in line with its longer-run trend relative to GVA (which is still a trend in decline), total GVA in the UK economy would have been around 0.5% higher in 2009, 0.4% higher in 2010, and 0.3% higher in 2011 (even without taking any multiplier effects into account).

So what might be the drivers of the downward trend in the share of commercial property in overall GVA? One possibility is that buildings are becoming more efficient, e.g. retail developments that offer more versatile and accessible space enable retailers to manage their stock more efficiently, and cut down on warehouse space. Another set of drivers concerns wider structural shifts in the economy, e.g. the changing structure of the UK economy, away from industrial activities that demand a large amount of space towards a knowledge-based economy in which workers sit close together, or even work from home.

The role of property as a factor of production

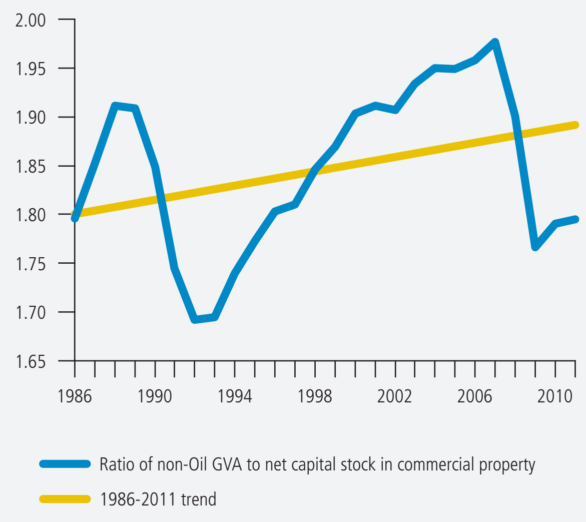
The research looked at the relationship between commercial property and the broader economy. The starting point was to adopt the National Accounts approach to come up with an estimate of the net capital stock of property (net of depreciation). This cumulates past levels of investment (inflation adjusted) and makes assumptions about the rate of depreciation in order to arrive at an estimate of the capital stock. It is a more economics-orientated approach in that it values investment in monetary terms rather than just the floorspace constructed and it explicitly allows for the concept that the economic value of assets will depreciate over time.

The growth in the net capital stock has been much greater than the growth in floorspace. The estimated capital stock, which is equivalent of around 22% of the UK's total net capital stock and 52% of the non-residential net capital stock, increased by 26.5% between 2000 and 2011, compared with an increase of only 3.3% in the Valuation Office's measure of total floorspace. The latter is because the floorspace data is weighed down by legacy space, much of which is of dubious economic value. This means that new space makes a smaller addition (in proportionate terms) to the total than new work does in the net capital stock estimates. The net capital stock estimates presented here give a much better indicator of the growing input of commercial property into the UK economy than do the floorspace data.

Figure 3 shows how the ratio of non-oil GVA to the estimated net capital stock in commercial property (currently £661bn at 2008 prices) has moved since 1986 (because the capital stock is valued at the end of the year, the 1985 figure is taken as being representative of the capital input for 1986, etc). As the estimates are built up from new work and depreciation data, it is not possible to undertake any estimates before 1985 as the new work data collection only commenced in 1955 and 30 years of data (the assumed service life) are required.

The fluctuations in the ratio illustrate something about the dynamics of the commercial property-non-oil GVA relationship. In the latter stage of economic upswings, non-oil GVA runs ahead of the commercial property stock and the ratio line in Figure 3 moves above its long-run average (in 1986-89 and 1998-2008). Whether new work is contemporaneous with non-oil GVA or lags behind (as in the late 1980s/early 1990s), the result is that the commercial property stock either continues to increase after non-oil GVA has fallen (late 1980s/early 1990s) or it levels off when non-oil GVA falls (2009-2010).

Figure 3: Non-Oil GVA to net capital stock in commercial property ratio



Source: Oxford Economics

What is clear is that there is a long-run relationship between economic activity and the net capital stock of commercial property and, by inference, even if there is a surplus of commercial property at any particular time, the process of economic growth and depreciation will eventually erode the surplus and there will be a renewed need for additions to the stock of commercial property.

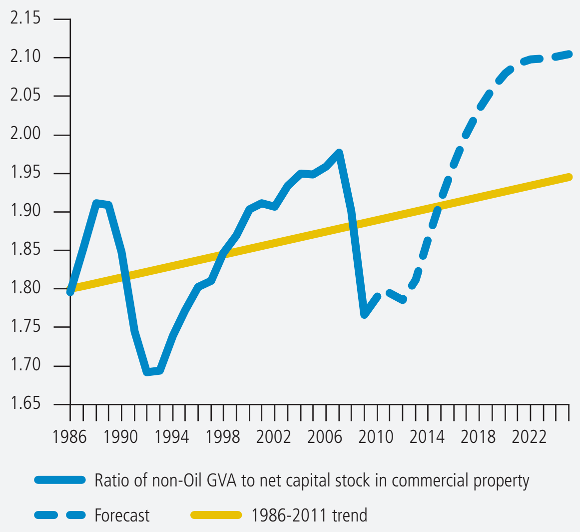
The future need for commercial property

The research analysis suggests that there will be consequences if the net capital stock of commercial property fails to keep up with non-oil GVA in the long run (less any 'productivity' trend that might be contained within the line shown in Figure 3). In the occupier market, the implication will be ever-rising real rents (and vice versa if the change in the stock continually exceed non-oil GVA growth). For the economy as a whole, rising real rents will reduce the return on other capital. If other capital and labour can be substituted for commercial property there will also be a decline in labour and total factor productivity growth.

According to Oxford Economics' forecasts, were new commercial construction work to stay at its 2011 level, the stock of commercial property will level off and the underlying demand (non-oil GVA adjusted for the trend) is likely to overtake supply (i.e. the net capital stock) in 2016. Such an outcome is very unlikely; the market mechanism and an eventually improving investment climate would mean that new commercial and industrial construction work would eventually pick up. However, there is no single path of future new construction work that will deliver a net capital stock for commercial property that is consistent with future non-oil GVA growth. It could be achieved by a rapid bounce back followed by a relatively flat period or by a more moderate bounce back followed by a period of sustained growth. Figure 4 shows the forecast upturn in net capital stock, produced using the June 2012 Oxford Economics non-oil GVA forecast.

There are a number of caveats to the forecast upturn in Figure 4. Most obviously, non-oil GVA might not recover as forecast. In this case, the demand for commercial property and new construction work will be lower. Such an outcome cannot be ruled out, but at least this framework can still be used to test the implications for future demand and new work. Second, the model used to generate the net capital stock estimates and forecasts might not be valid. However, the arguments advanced above and the estimates generated make sense in the context of GVA and rental growth.

Figure 4: Commercial property non-oil GVA relationship



Source: Oxford Economics

Finally, it must be recognised that this is a highly aggregative model that conceals a myriad of details. A useful extension of the work would be to disaggregate it into the different property sectors. Disaggregated data on new work, however, are only available back to 1980 (compared to 1955 for all new work) and a longer run of data is needed to repeat the perpetual inventory technique used here. However, while sectoral detail would be useful, it does not invalidate the conclusions from the exercise. Focusing on the aggregate allows clarity and emphasises what are very significant conclusions for the commercial property development and construction industries.

Terms of endearment

Matthew Abbott, Mercer

Property fund terms have really come under the microscope since the market took a turn for the worse almost six years ago. From simple things like investment restrictions to more complex terms such as redemption mechanisms and fee structures, all have been scrutinised much more closely.

Not only has fund governance come under increased scrutiny, but the behaviour and needs of investors have also changed. The industry has been through one of the most challenging times in its history and there are no signs that these challenges are over. Although the rapid fall in property prices finished almost four years ago, the aftermath continues to be felt today.

In my view, the industry has done relatively well at trying to 'future-proof' itself. Fund documents which date back to the 1970s have in many cases been updated to provide better alignment and more reasonable terms, and fund managers have in many instances improved communication channels and transparency. But there remains more that can be done.

So what are the key elements of fund governance that still need addressing?

Investor advisory committees (IAC)

First things first, a pooled fund should have the best interests of its investors at the very forefront of its operation. If a fund gets into trouble or big decisions need to be made, these decisions should be made in a collaborative way, allowing investors to express their views and enabling managers to act on these views. There is still sometimes a mindset that a fund 'belongs' to the investment manager who launched it, as opposed to its investors, although by and large this is becoming less prevalent. I believe that this needs to change; there needs to be increased communication and investors need to be given a forum in which to discuss any issues and express their views. It is, after all, their capital which enables the fund to continue.

Of course there will be instances when investors disagree with each other, and consultation exercises will often not be easy. However, I think the introduction of an IAC is a necessary change which will go a long way to restoring faith and trust from investors in what is proving to be a very fickle marketplace. One year from now, I would like to see many more funds operating such a committee. They do not necessarily need decision-making powers (in fact I think that that could well be dangerous), but they should be consulted on any changes to the fund strategy and get involved at an early stage when funds are facing (or even appear to be facing) some issues. The presence of a committee also means that investors are encouraged to talk to each other; something that up until fairly recently has not happened often enough. Whether such a committee should also include some independent representation is also a question that needs some thought.

Change of manager provisions

Extending the idea above of 'whose fund is it?', let me consider a specific term: no fault divorce clauses. These should be standard practice. This change in the governance environment would alter the mindset of how managers run their funds. Communication and transparency would improve, strategy would be put under greater scrutiny and managers would become more engaged with investors. In short, the market would become better governed.

Fees

Fees will always be a source of disagreement. Fund managers need to be properly remunerated so that they can do their job well and attract high-class talent. I have seen instances where managers have been appointed based more on low fees than on ability. It goes without saying that this tends to end in tears. As consultants, we need to be careful of putting pressure on fees. Fees should be set at a level which enables the manager to do what they say they are going to do, and do it well.

If this is not the case and fund managers are no longer able to operate sufficiently profitably, then the industry will consolidate and there will be less choice which would be no good to anyone (except the lucky few juggernauts of managers who end up dominating the market). One only needs to look at the property multi-manager industry to see how this has taken hold; the amount of choice has pretty much halved in the last four years or so and a successful long-term business is now only viable with the luxury of scale. It would be better if investors had a range of different types of business to choose from all the way from large multi-asset houses to smaller boutique outfits.

In respect of performance-related fees, my view is that for market-benchmarked, moderate risk funds, they often do not serve the purpose for which they are intended. The notion that a performance-related fee aligns the manager with its investors carries little weight with me, as managers should be aligned purely by the fact that their reputation is on the line.

In fact, performance fees can incentivise managers to deviate from their stated strategy by taking undue risk. It makes sense to me that a fund should be rewarded the most if it meets its target, not if it exceeds it. If a manager exceeds its target it is either through luck (which should not be rewarded), market performance (which should not be rewarded), excessive risk-taking (which should be disincentivised) or through skill and judgment. Whilst skill and judgment should be rewarded, it is often impossible to separate this out from factors for which the manager is not responsible and, besides, they will be rewarded through reputation, which will enable that business to go from strength to strength. In my view, that should be incentive enough.

For higher-risk, closed-ended funds the arguments are different. Such funds buy assets, manage them for a finite period and try to extract value. So long as a manager sticks broadly to its stated strategy (again this comes back to trust), it should be rewarded for doing a good job. So perhaps the performance fee should be relative to some measure of market return as opposed to an absolute return figure (assuming this exists). Other requirements are that fees should be taken at the end of the fund's life, should be based on aggregate realisation (as opposed to being done on a deal-by-deal basis) and, in the case of open-ended funds, should be paid over a period of time with a clawback mechanism, allowing underperformance to reduce the fee payable.

Benchmarks and targets

We are seeing a gradual shift in what some of our clients are looking to achieve from their real estate portfolios and this has clear implications on the targets and benchmarks they give to fund managers. There is an increasing focus on clients looking at their end goal: can they meet their pension payments and do so in a risk-controlled manner? This has meant that the focus is on the level, predictability and security of income, rather than market beta.

The trend will only continue, but it is unlikely to replace low-risk beta exposure, at least not any time soon. I envisage two key objectives for clients – those who want to achieve market beta with minimal surprises and those who want a secure absolute type return or access to a broad set of best ideas.

Liquidity

Property is an illiquid asset class. It is also a cyclical asset class. Combine these two features and the result is that managing funds on an open-ended basis can be a real conundrum at times. We have already seen the downfall of some funds which had been running for decades and I suspect there will be more.

The problems are not just evident in falling markets when redemption requests are high. The converse problem exists when lots of capital is flowing into funds too. Is an open-ended fund obliged to accept cash as and when investors want to invest or should they queue capital outside the fund and take capital in as and when they can invest it? This is not an easy question to answer and different investors have different views.

I think there needs to be an acceptance that property is illiquid. The assumption that investors can get exposure or reduce exposure 'immediately' should be dispelled. Managers should not be obliged to accept capital as and when it is subscribed for and they should not be obliged to return capital in the very short term if this compromises remaining investors or the fund as a whole. For me, property is a long-term investment, where there should be an acceptance that investing or disinvesting can take some time. Clauses around how much of a fund can be redeemed each quarter and queuing subscriptions (but having a time limit beyond which the commitment would lapse) both make sense to me, but regardless of fund clauses, I think this is more an issue of acceptance by investors that real estate just is not liquid.

Pricing and valuation

When investors subscribe for or redeem units most property funds use a bid:offer spread which reflects the costs associated with buying and selling property. Currently, this spread takes into account stamp duty, agents' fees and legal fees. There are some structures in which the bid price can be altered to take into account prevailing market conditions and in severe market conditions the discount which redeeming investors were offered was very significantly below NAV. In other circumstances, funds saw large falls in their NAV because they were in a position in which they had to sell and the market knew this.

The matter of pricing/valuation is currently the most talked about aspect of fund governance and I suspect the topic will run and run. Considerations such as whether a forced sale position should be reflected in the NAV or the bid price, whether more than one valuer should be used, who should be responsible for appointing the valuer (maybe the investors should) and in instances where the bid price must be set, who should do this, are all unclear. Although the system will never be perfect (real estate is heterogeneous after all), it is pleasing to see that many industry professionals are taking the matter very seriously. Communication of the drivers behind valuation changes also needs to improve.

Conclusion

Although the property fund environment continues to evolve, changes do still need to happen. Investors should accept that property is an illiquid and long-term investment and need to understand the possible implications of this before they commit to the asset class. Communication needs to improve, many fund terms still need to be modernised, more influence needs to be granted to investors and with this, investor sophistication and governance also needs to improve.

The industry has been scarred by the events of the last six years but I think that, if changes are made and more accountability is shown, the industry can continue to flourish and where trust has been eroded it can be restored.

Secondary liquidity and misleading NAVs

Dan Batterton, Legal & General Property

When we talk about indirects, we refer to investing in property and gaining an exposure to real estate by buying units in a fund that holds properties, rather than actually purchasing a physical asset directly.

Over the last 20 years there has been a rise in closed-ended sector specialist funds. There are many advantages to these:

- Sector specialist management skills;
- Lower transaction costs;
- Diversified exposure;
- Access to larger lot sizes; and
- No primary liquidity removing 'cash drag'.

A key attraction of this form of investment, relative to holding a physical property, was perceived to be increased liquidity; units within a fund are homogenous and can be traded in varying volumes on the secondary market with low transaction costs. However, there has been criticism on a regular basis that unlisted funds have failed to provide improved liquidity and are, in fact, less liquid than physical property.

This article explores whether unlisted funds really are illiquid and the reasons for this perception.

Comparing unlisted funds with the listed sector

It is interesting to compare the respective liquidity of the unlisted and listed sectors, given there is a general perception that stock market listed funds offer ongoing liquidity.

SEGRO is a publicly-listed company that aims to "be the best owner-manager and developer of 'industrial' properties in Europe and a leading income-focused REIT." Well-established and comprising a large portfolio of high-yielding industrial property, the Industrial Property Investment Fund (IPIF) is a good comparable in the unlisted universe.

Figure 1 shows the relative trading volumes of IPIF and SEGRO as a percentage of units/shares in issue from July 2009 to March 2013 – the period since SEGRO acquired Brixton.

Since July 2009, 57.7% of units in IPIF have been traded. This compares to 64.0% of shares in SEGRO. The level of trading within SEGRO is very consistent over time, while IPIF has shown larger variations in volume from one month to the next. This is not surprising given IPIF has only around 100 unit holders.

This is only one example, so cannot be used to provide definitive proof of liquidity. However, it does show that these two investment vehicles running similar strategies offer similar liquidity.

In the listed sector, market makers provide continued liquidity. There are no market makers in the unlisted sector; brokers such as JLL and GFI have done excellent work in recent years to match buyers with sellers but the lack of a market maker does technically reduce liquidity.

There is liquidity in unlisted funds, but not at NAV

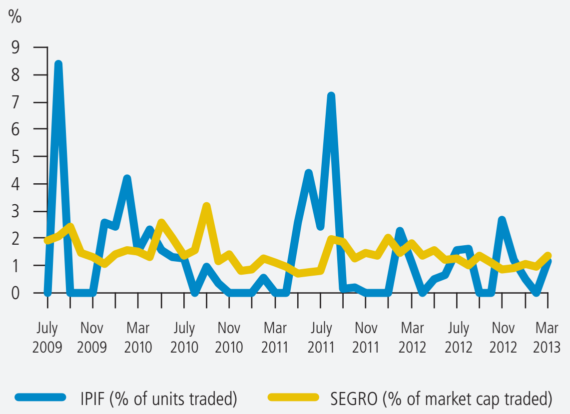
A key area affecting liquidity, or the perception of it, is pricing.
A report bid and offer is provided and updated continually for REITs. Investors can then hold any REIT investments on their books at a price very close to a realisable value. This realisable value may be above or below the net asset value (NAV) of the underlying assets within the REIT.

Unlisted funds also trade at premiums or discounts to NAV, although funds do not report a realisable value. Funds such as IPIF report NAV on a monthly or quarterly basis, with investors usually holding units at NAV. It should be noted that different unlisted funds use different accounting standards and so the NAV of two funds is not always directly comparable.

The value of the underlying assets is not a fair assessment of the value of the units. The NAV comprises the current valuation of all properties within the fund plus cash, less incentives, drawn debt and capital provisions. An adjustment may also be made for any mark-to-market valuation of any swap contracts, although this is not always included.

The underlying properties have been valued in accordance with Red Book requirements, which capitalises the expected future cashflow. Valuing unlisted funds at NAV does not do the same, as an owner of units does not receive the cashflow of the underlying property. Instead, they receive a cashflow that has been altered to take a number of things into account, including fees, debt, transaction costs, operational expenses and cash. Debt particularly may increase or decrease the expected future income stream.

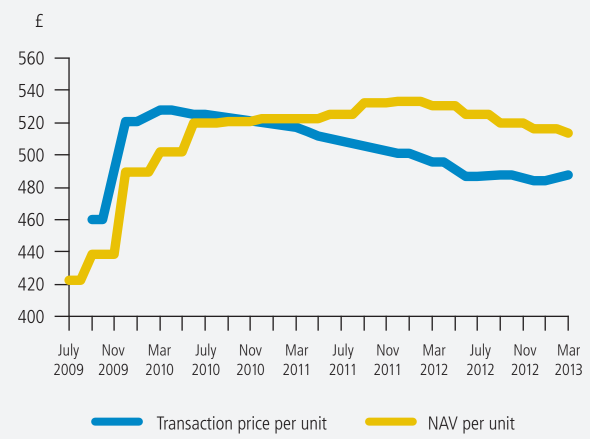
Figure 1: Trading volumes of IPIF & SEGRO



Source: State Street, SNL

Sophisticated investors in the unlisted space are modelling expected cashflows on units in funds. One element of that cashflow is rental income. Amongst other things, investors will assess sustainability, the strength of corporate governance, the manager's reputation and track record, and liquidity. All of these, as well as the underlying portfolio, impact the price a unit is worth. An entry price is then derived that would deliver the required rate of return to investors.

Figure 2: Trading price vs. NAV per unit of IPIF



Source: State Street, SNL

Holding unlisted investments at NAV does make sense if, as an investor, you have no intention of selling your units and expect to exit at fund expiry, when all assets have been sold and something near to NAV is returned. But, if there is any intention to trade, the units' NAV is not a fair measure of worth.

To believe that unlisted funds are illiquid because you cannot trade them at NAV demonstrates a misunderstanding of what they are and how they trade.

Calculating fair value

An independent valuation of units in a fund can be procured. These valuations look at the expected cashflow generation, underlying assets and market comparables of trades within similar funds. A number of fund management houses already receive these regularly for the units they own. This allows them a better estimate of realisable values at any given point, particularly important if the units are held in a vehicle with investors subscribing and redeeming units. The fair value assessments are not guaranteed sale prices; they are best estimates, using all available evidence, in the same way that a property valuation is.

There is a commonly-held view that the price unlisted units trade at will be affected by the volume of units being sold, therefore a single fair value is not valid. This is, however, the same in the listed market; equity dealers assume that if they were to trade more than 10% of the daily volume they will move the price.

The argument against a fund being held at 'fair value' rather than NAV is that there are no observable prices as, unlike a REIT, it is not a publicly-traded vehicle and the only disclosed metric is the NAV. However, with the inception of trade platforms there is increased market transparency. A number of funds already report the price of trades executed, but this information could be more openly reported and by a wider range of funds. This would improve the market evidence available, thereby providing a more accurate estimate of realisable value.

The argument for unlisted funds to be held at NAV is also less compelling following the regulatory pressures imposed by IFRS 9 and IFRS 13, which are now coming into effect. Both policies encourage a move away from holding vehicles at NAV in favour of fair value. Fair value is defined by IFRS 13 as: "The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date."

Even if calculations of NAV were uniform across all funds, it is not an accurate measure of value as it does not (like the RICS Red Book valuation) derive a valuation from a future cashflow, but rather a simple aggregate of assets and liabilities at any given point in time. The continued use of NAV as the basis of valuing holdings in unlisted funds creates a perception of illiquidity, as NAV is not an achievable sales price.

Impending regulation, in the form of IFRS 9 and IFRS 13, as well as improvements in market transparency, dictate that the independent valuation of units should be the way forward. This is especially true for unit holders in open-ended, frequently traded funds, who need to know what their realisable assets are at any particular point in time.

Unlisted funds can provide liquidity – easily-divisible ownership, with low transaction costs and fast settlement makes them an attractive addition to liquidity management, as well as holding them purely for performance reasons. But they need to be held at a realisable value and not at NAV.

Social housing – the new alternative?

Given the growing investor interest in the social housing sector, the IPF Residential Investment Special Interest Group, chaired by Robin Goodchild of LaSalle Investment Management, arranged a seminar on the topic in late March. The article below summarises the presentations by our three speakers, all active in this sector.

David Cowans of Places for People outlined the huge changes in housing provision in the UK. These include an increase of 5.8m in the number of households by 2033, from the current 23.4m, and an increase in population of 8m by 2026 alone. In terms of age profile, one in six people are currently over 65 and this will increase to one in four by 2050.

64% of UK housing market is owner occupied and this share is unlikely to increase. Social housing provision has been declining since 1970s, while the private rented sector (PRS) has grown dramatically over the same period such that the PRS has probably overtaken social rented housing in scale and could account for more than 5.5m households by 2016.

Social housing exists to provide housing at discounted rents to those who cannot afford to pay market rent. The government used to give a capital grant to housing associations (registered providers (RPs)) in order to reduce rents. This grant is equity-like in that it is interest and indexation free, not repayable unless the property is sold or no longer in use as social housing and cannot be redeemed from surplus revenues. As a result of this grant funding, the RPs have been very active – the 1,500 of them now own 2.6m homes and the 60 largest account for half of the social housing stock in the UK.

Funding social housing

However, the grant regime has now changed dramatically. Originally the grant was 100% of cost of provision but has since reduced over time to 20%. There is a lot of debate as to whether the current model is sustainable, given that other sources of finance now play a much more significant role.

Rob Beiley of Trowers & Hamlins emphasised the scale of the structural changes by pointing out that the last two years had seen more new entrants to the social housing funding sector than in the previous 20 years. Traditionally, the RPs are financed by grant plus secured loans but now finance can be in the form of private placements, overseas investors and joint ventures with fund managers. The change was triggered by the Housing and Regeneration Act 2008, which for the first time allowed social housing providers to register with the Social Housing Regulator (part of the HCA) on a 'for-profit' basis.

The Regulator has an overview role and prescribes standards relating to RP governance and viability. Its intervention powers are quite draconian if it has concerns regarding a RP, as demonstrated by its active role in the recent rescue of the Cosmopolitan Housing Group, which owned nearly 14,000 properties, by the Sanctuary Group.

David Cowans, Places for People

The HCA has been 'spooked' by the Cosmopolitan failure as the Group was brought down essentially by its diversification into student housing, which did not perform very well. At the same time, the HCA recognised that the likely further reduction in housing grant will force more RPs to find more external sources of finance, particularly as they are being encourage by government to build more housing. In response to the situation, the HCA launched a review document, 'Protecting Social Housing Assets in a more diverse sector', which seeks views on how best to protect social housing assets from the RPs non-social housing assets, while still allowing the RPs to operate effectively. The review suggests the solution may lie in ring fencing social housing activity. The problem for the RPs is that most of their existing businesses would not comply with the proposed separation of activities and in the context of ever reducing levels of government grant, they will need cross subsidisation and guarantees.

Robert Beiley, Trowers & Hamlins LLP

Fundamentally, the question is whether the HCA should underwrite the RPs or protect the asset value attributable to grant funding.

Investor interest

Pete Gladwell of Legal & General Property said that the social housing sector was of particular interest to investors focused on matching liabilities. The sector could be viewed as a bond-type 25+ year investment, with index-linked income growth and credit exposure to the respective RP or local authority, underpinned by government subsidy (enhancing revenue stability) and the likelihood of intervention in the case of acute liquidity stress. All this means that the sector's credit risk is generally assessed as 'investment grade'.

Pete Gladwell, Legal & General Property

The other attractions include diversification benefits – it performs well even in times of financial crisis – and from Legal & General's perspective, the sector 'ticks' the 'socially beneficial' and 'sustainability' boxes.

He was concerned about the HCA review proposals to ring fence social housing activity as it moves away from the long-term stability regime currently in place. This sector is a government priority in that demand for social housing outstrips supply by approximately two to one and its provision is central to government reforms, particularly around welfare. The ongoing capital required to meet the government's affordable housing targets is in the order of £4bn a year so we need to ensure that the regulatory framework is one that works for investors.

Institutional attitudes to investment in UK residential property

Pam Craddock, IPF

Considerable interest was generated by the research conducted in 2012 to inform the IPF's response to the Minister for Housing and Local Government's call for evidence of how to encourage greater investment in privately rented properties (the Sir Adrian Montague Review), subsequently published by the IPF Research Programme as Short Paper 16 under the title 'Institutional Attitudes to Investment in UK Residential Property'. As a result, the IPF's Residential Special Interest Group considered that a further survey of investor attitudes and intentions was warranted in order to see what, if any, changes in residential investment have taken place over the last 14 months.

Over 60 parties were invited to participate in the survey, representing a range of organisations – from UK pension funds and life assurance companies to property companies, including REITs, as well as fund managers, local authorities and other financial institutions. As with the 2012 study, these bodies included both investors in the sector and those without any current exposure to residential property within their investment portfolios. Responses were received from 44 organisations, 34 of which also contributed to the survey in 2012.

Profile of the respondents and current investment in residential property

As may be seen in Figure 1, the total assets under management (AUM) of the 44 respondents providing data is estimated to be over £2.9tn, of which UK real estate comprises over £166bn or around 5.7% of all investment. More than 80% of contributors (37) hold residential property in their UK investment portfolios, which includes student accommodation and development land. Of these, 33 respondents quantified the size of their holdings, which average around £325m although the range of exposure is considerable, from over £1.8bn down to £1m or less (three respondents).

Methods of investment and preferred asset types

By far the most popular method of holding residential property is through direct ownership (33), whilst around a third of investors may also participate via joint ventures (12) or investment in private funds (10). Only one respondent identified listed vehicles as a means of exposure to the sector.

Figure 1: Profile of survey participants

Type of organisation	No. respondents	Total AUM (Global) £m	Real Estate AUM £m	No. residential investors	Residential Investment £m
Fund manager	16	1,465,197	87,973[1]	12	3,101[2]
Investment manager	10	1,305,692	29,450	9	1,450[3]
REIT	5	26,193	25,989	5	992[4]
Pension fund	5	69,879	4,586	3	135
Other[5]	8	37,192	18,435[6]	8	5,176[6]
Total	**44**	**2,904,154**	**166,433**	**37**	**10,854**[7]

Note: The values shown for assets under management (AUM) are based on the proportion that real estate represents of total AUM, where sufficient information was provided to facilitate this calculation.

Figure 2: Type of assets (2012 figures in brackets)

		MR/ASTs	Development Land	Student Housing	Ground Rents	Social Housing	Other[8]
Total no. respondents	37 (28)	23 (21)	19 (15)	20 (11)	10 (10)	3 (5)	8 (6)

Note: 2012 survey included regulated tenancies as an asset category in which 25% of respondents were invested.

1 14 responses

2 11 responses

3 Eight responses

4 Four responses

5 Includes sovereign wealth funds, private investors, listed & private propcos

6 Seven responses

7 15 respondents identified their holdings to include joint ventures, private funds and/or listed vehicles. Therefore, this figure is likely to overstate the total investment in residential due to an element of double-counting.

8 Examples of 'Other' types of residential asset included: development, retirement village development, equity release, retirement housing, shared ownership, residential care homes, houses in multiple occupation and statutory tenancies.

Figure 3: Reasons for investing by existing investors

	Rank									
Reason to invest	1	2	3	4	5	6	7	8	9	Score
Returns profile	11	7	2	0	2	0	3	2	3	195
Development potential	8	5	1	4	1	5	2	2	1	179
Stability of income	4	5	7	2	3	2	4	0	3	175
Stability of capital values	1	3	8	5	3	2	5	0	2	159
Low correlation with other assets	2	4	5	1	8	2	4	1	1	154
Part of mixed-use holding	8	0	1	2	4	1	2	2	3	128
Defensive investment	2	3	1	4	6	0	5	1	1	121
Portfolio legacy	7	3	1	1	1	0	1	3	6	120
Other	4	0	0	0	1	0	2	1	3	61

The spread of residential property invested in is primarily concentrated in three principal types: market rents/assured shorthold tenancies (MR/ASTs), student accommodation and development land, although 10 or more contributors have exposure to ground rents and/or social housing (see Figure 2). More than half of respondents (20) identified student accommodation as forming part or all of their residential investment, of whom 17 hold other types of residential investment.

There were insufficient responses to allow further analysis by reference to percentage holdings other than five investors indicated that they have only invested in market rented/AST property (in excess of £290m), two wholly in development land (£142m) and one in social housing (sub-£1m).

Rationale for investing in residential property

Figure 3 summarises the reasons that existing investors gave for investing in residential property. A significant majority (30) identified the returns profile as being a key consideration, of whom 11 considered it to be the leading driver. Whilst slightly fewer (27) respondents identified development potential are their primary consideration, this may be due to interests in commercial property with residential development potential. In terms of overall importance, stability of income was the third most highly valued criterion, followed by capital value stability and low correlation with other asset classes. A number of respondents identified their exposure as forming historic holdings, being incidental to larger commercial investments.

Existing investors were asked whether they intended to change their residential investment exposure over the next 12 months to three years. Fifteen anticipate they might increase their exposure over this period with another 16 definitely intending to do so. Only four respondents might or will decrease their exposure over the next 36 months. The extent of new investment disclosed by contributors could be up to £3.84bn, their main focus of interest being in MR/AST properties.

Non-investor reasons for not investing

Only seven of the 44 participants in the 2013 survey, i.e. 16%, do not currently invest in residential property. The survey questionnaire suggested a number of factors as potential deterrents to investing in the sector and asked participants to identify those applicable to them. The summary of their responses is set out in Figure 4. The foremost reason identified was that of low income yield. This contrasts with the 2012 survey responses, when the main barrier was perceived to be management issues.

Asked if they would commence investing in the residential sector within the next 12 months or over the next three years, only one of the seven has no intention of doing so. Of the remaining six, three contributors may or intend to invest in the next year, with the other three possibly investing within the next three years. None of the respondents would indicate how much they might be willing to invest but identified their preferred types of residential investment to be MR/ASTs (three), student accommodation (three) and social housing (one). Other categories mentioned that may be of interest were affordable rents and lending, i.e. debt.

What else can government do?

All respondents were invited to give their views on what more government could do to make residential more attractive or to increase existing investors' commitment to the sector. Comments fell into broad categories, including:

- Do nothing or pledge not to tinker with the sector;
- Changes to the planning framework, such as establishing a separate use class order, and S.106 agreements, reducing or eliminating the social housing element of developments for private rented stock;

Figure 4: Reasons for not investing (2012 responses in brackets)

Total no. respondents 7 (13)

Factor	No. responses	%
Income yield too low	5 (9)	71 (64)
Lack of liquidity/ insufficient market size	3 (9)	43 (64)
Pricing not right	3 (6)	43 (43)
Reputational risk	3 (5)	43 (36)
Just too difficult/ management issues	2 (12)	29 (86)
Difficulty of achieving sufficient scale	2 (9)	29 (64)
Political risk	0 (4)	0 (29)

- Tax treatment: reduction or removal of VAT; introduction of taper relief on CGT to encourage more longer term investment;
- Change in REIT rules to make indirect investment possible through residential REITs.

Summary

Overall, the survey findings indicate a continued commitment and gradual increase in investment in the UK residential sector. The potential pipeline, presuming there is sufficient stock to meet these aspirations, is in excess of £3bn from existing investors.

What is also worthy of note is that capital is flowing in both directions, as mature investors are actively managing their residential asset exposures, increasing and reducing their positions in order to match individual fund strategies.

Valuing French and German property

Gareth Sellars of Jones Lang LaSalle and James Bauer of Real Estate Advisory Group (REAG) spoke on valuation practice in France and Germany respectively at the recent seminar, organised by the IPF International Special Interest Group. They kindly agreed to elaborate on their presentations in conversation with Sue Forster, as detailed below.

Sue Forster (SF): What regulatory frameworks are in place for valuations in France and Germany?

Gareth Sellars (GS): In France, valuation practice conforms generally to RICS and TEGOVA standards, particularly where the client is a bank or an international investor. The recognised norm is the Red Book, using the best practice standards set out in the 'Charte de l'Expertise en évaluation immobilière'. This is essentially a handbook produced by a committee made up of the main professional valuation groups operating in France. One of these is the French Association of Property Valuation Firms (AFREXIM) – comprising the nine leading French companies specialising in property valuation.

The Autorité de contrôle prudentiel (ACP) regulates insurance company valuations

James Bauer (JB): Most valuations are carried following the German ordinance for property valuations, 'ImmoWertV', which is more prescriptive in terms of methodology than the Red Book, which is more ethics-based.

Valuations for mortgage lending are undertaken in accordance with the Pfandbrief Act 16, which is intended to result in a conservative 'sustainable value'.

Red Book valuations are mainly carried out by major international firms for their non-German clients.

SF: Are there any restrictions on who can undertake valuations in your market?

GS: In France anyone can call themselves a valuer. However, those undertaking valuations that come under the control of the Autorité des marchés financiers (AMF), which is the French equivalent of the FSA, will need to be credited by the AMF. Furthermore, many investment managers insist that their valuers are an AFREXIM company.

The domestic banks generally require Red Book valuations but as the German banks have been very active recently, several valuers are now sitting the HypZert certification exam (see below) that allows them to carry out mortgage lending valuation on behalf of German banks.

JB: Yes, BaFin (equivalent of the FSA) requires that any valuers undertaking mortgage lending valuations has the CIS HypZert (MLV) certificate, which confirms that they have satisfied the requirements of BelWertV (the ordinance regulating the determination of mortgage lending values).

Most 'Vereidigte Sachverständige' valuers follow the ImmoWertV. Those working for international companies are generally RICS qualified.

Gareth Sellars, Jones Lang LaSalle

SF: What information do you collect typically before undertaking a valuation?

GS: There are no requirements to ask for specified information. However, Jones Lang LaSalle has a comprehensive 'wish list' that is in line with AFREXIM regulations, which is sent at the start of each instruction although the reality is that the content and quality of information provided can vary considerably. Valuers do not measure properties in France – this is undertaken by an accredited professional (a Géometre).

JB: A data request is sent out and information on zoning and planning is obtained from the appropriate authorities. Clients are asked to provide information and this is double-checked in house. Building measurements are done separately, on request of the buyer.

James Bauer, Real Estate Advisory Group

SF: Can you outline the main valuation methodologies used in France and Germany?

GS: As mentioned above, the French valuation regime is very similar to the Red Book. French valuers typically adopt at least two methods as per the recommendations of Charte de l'Expertise.

Historically, the comparison method has been most frequently used by the market – until about 15 years ago this was a capital value comparison. The income capitalisation approach is now widely used, as are DCFs.

Other valuation approaches used in the UK, such as development appraisals, depreciated replacement cost and the profits method are much the same in France.

JB: The Baugesetzbuch (BauGB – Building Code) defines the basis of value and the ImmoWertV, in conjunction with WertR (valuation guidelines) set out approaches, methodology and even typical valuation inputs. The combination of the above is very prescriptive. There are three main recognised approaches: Vergleichswertverfahren (sales comparison); Ertragswertverfahren (income approach); and Sachwertverfahren (cost approach). These are applied according to property type.

The valuation (Ertragswert) looks at the values of the land and buildings separately – as per the example in Figure 1.

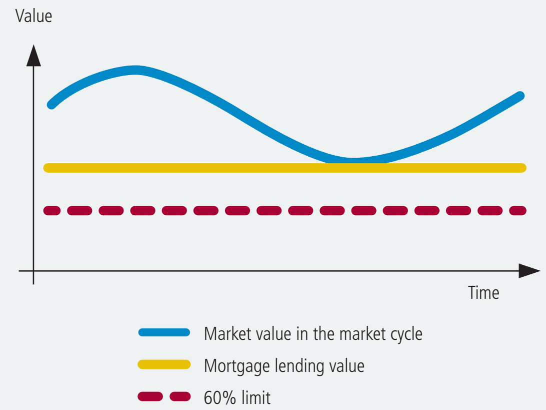
Mortgage lending valuations have to conform to strict rules, which are designed to derive a value that is achievable at any point in a 20-year market cycle (see Figure 2). The Pfandbrief banks may lend up to 60% of the valuation – Figure 3 shows an example of a Pfandbrief valuation.

Figure 1: German approach to valuing land and buildings

Gross rent	**€150,000**
Less non-recoverable operating costs	€30,000
Net operating income	€120,000
Land value (per annum) (500.000 x 4.75%)	€23,764
Net income attributable to the buildings	€96,236
Years Purchase 60 years (4.75%)	19.74
Value attributable to the buildings	€1,900,000
Land value	€500,000
Ertragswert	€2,400,000

NOTE: Assumes land value of €500.000 obtained from market souces – Bodenrichtwertkarte

Figure 2: German mortgage lending valuations



SF: Does the property sector being valued have any impact on the approach?

GS: The key focus for residential property is the value of the income, rather than the underlying capital value, as the tenants' security of tenure is well-protected under law.

JB: Residential investments in Germany would also be valued on an income only approach.

SF: What assumptions do valuers make regarding matters such as rent review, lease renewals and recoverability of outgoings?

GS: Rents are indexed annually in standard French leases. At the end of a nine-year lease of a retail unit, the tenant has the right to renew the lease without a market rent review. There would be a review for office use.

If indexation during any lease increases the initial rent by more than 25%, the tenant can ask for a review back to market rent. This has happened regularly in the logistics sector in recent years as market rents have remained relatively flat while indexation has run at high levels.

The market rent for an office is quite often below the actual indexed rent. In this instance, valuers will assume that at the end of the term the rent will drop to the market rent or the tenant will leave.

Commercial property leases in France allow for the recovery of maintenance and taxes but not those relating to structural repairs.

JB: Standard leases are for 5-10 years at a rent indexed annually. For a 10-year lease, there will be a five-year break clause. Valuers will make a judgement as to the rent achievable at the end of the lease on an individual building's basis.

With regard to other costs related to offices and retail units, the landlord may render service charges covering management fees etc. but not the cost of repairs.

SF: How easy is it to get comparable evidence for valuations?

GS: According to the Jones Lang LaSalle 2012 Transparency Index, France is the seventh most transparent market in the world (the UK ranks second after the US) and it ranks first in terms of transaction process (quality and quantity of pre-sale information, fairness of the bidding process, ethical standards of property agents).

The 'Big 4' (BNP Paribas Real Estate, CB Richard Ellis, DTZ and Jones Lang LaSalle) set up IMMOSTAT in 2001, which collects data (rents, supply, take-up and investment transactions) on commercial market in the Ile de France on a quarterly basis. As in the UK, detailed information on respective regional markets lies with local practitioners and a large number of French valuers have contacts with local notaries.

JB: The German market is less transparent than that of France or the UK but there are a number of sources of information:

- research published by major international and national firms;
- public authorities (local valuers commission or municipality) collate, interpret and publish data – usually annually. Generally not raw in format and therefore valuers accept data that has already been interpreted;
- many authorities publish maps showing land values for commercial and residential use (Bodenrichtwerkarte); and
- then there is anincreased reporting of deals but lack of forensic data providers.

Figure 3: Example of a Pfandbrief valuation

INCOME APPROACH		
Land value		
600 sq m @ €5,200 per sq m		€3,120,000
Gross income		
2,000 sq m of office space @ €30 per sq m (monthly substainable rent)		€720,000
Gross annual rent		**€720,000**
less operating expenses:		
(costs that are not reimbursable)		
Management costs		
(3% of gross income)	€21,600	
Replacement reserves,		
maintenance costs on office space		
(2,000 sq m @ €15 per sq m)	€30,000	
Collection loss		
(4% of gross income)	€28,800	
Total operating expenses	**€80,400**	
in % of gross income	11.17%	
Minimum operating expenses according to BelWertV	15.00%	
Stated operating expenses		**€108,000**
Net annual income		**€612,000**
Market capitalisation rate: 5.5%		
Minimum capitalisation rate according to BelWertV: 6.0%		
Return on land (land value @ 6.0%)		**€187,200**
Net income on building		**€424,800**
Capitalisation rate: 6.0%		
Remaining useful life: 60 years		
Multiplier: 60yrs @ 6.0%, also Annex IV to the BelWertV	16.16	
Income value of the building		**€6,864,768**
Land value		**€3,120,000**
TOTAL INCOME VALUE		**€9,984,768**
TOTAL INCOME VALUE (rounded)		**€9,980,000**
MORTGAGE LENDING VALUE		
(income generating properties)		**€9,980,000**
Inclusion in cover (lending limit 60%)		**€5,988,000**

SF: Has the shortage of debt finance had any impact on valuation?

GS and **JB** agreed that the impact was minimal as the banks are refinancing themselves very cheaply, so are not under pressure to sell large amounts of property.

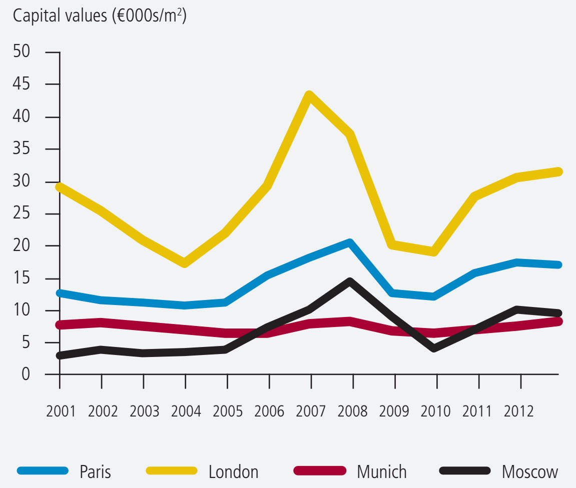
SF: What are the typical hold periods for property in France and Germany?

GS: Insurance companies and pension funds have on average longer hold periods in France than in the UK. In the major cities, we are seeing sovereign wealth funds buying up the big buildings to hold for a very long period of time. The hold periods of other international investors are typically between five to seven years.

Overall there is a lot less volatility in the market – see Figure 4, which compares the movement in capital values for Paris, London, Munich and Moscow

JB: German insurance companies and pension funds have long hold periods in excess of 10 years. Most international business plans are of 3-5 years' duration.

Figure 4: Changes in capital value



Source: JLL Global Real Estate Database

SF: What consideration do valuers give to the sustainability/energy efficiency of a building?

GS: The principal factor is location. In central Paris, a building will be refurbished every 10-20 years, so these considerations are not very relevant to the building's valuation and new/refurbished buildings tend to have the required 'labels'. However, in the first outer ring of Paris, there is an impact as long-term vacancies are driven partly by sustainability requirements, rather than buildings being obsolete in themselves. This is particularly an issue where there is high vacancy and a high number of 1960/70/80s' buildings, such as the Peri-Defense. The government is currently promoting the change of use for obsolete commercial buildings to residential

JB: German building codes are very strict so new buildings automatically meet the standards. Older buildings (20-30 years old) are being completely refurbished but not all have been rated in terms of their sustainability.

The general concern is that family homes are contributing far more to the total level of carbon emissions than those from commercial buildings.

IPF legal and regulatory round-up

This table gives an overview of some of the main legal and regulatory proposals affecting UK real estate investment. It includes details of timings and how the various issues impact the real estate and real estate funds industry. The table is divided into legal developments – UK/general, regulatory, banking and competition. The issues are in no particular order.

Amanda Howard, Partner, Nabarro

Christine Ormond, Knowledge Lawyer, Nabarro

LEGAL DEVELOPMENTS – GENERAL/UK

Lease Accounting Rules

A revised exposure draft on accounting for leases was published in May 2013 by the International Accounting Standards Board and the Financial Accounting Standards Board (the Boards).

The core principle that lessees should recognise assets and liabilities arising from a lease on its balance sheet remains, but the revised exposure draft allows both lessors and lessees to exclude most variable lease payments and, importantly for lessees, to take renewal options and the period after a tenant's break right into account only if the lessee has a significant economic incentive to extend the lease or not to exercise the break. Leases of less than 12 months would not need to be recognised on the balance sheet.

Timing

Feedback on the proposals in the revised exposure draft is requested by 13 September 2013. The Boards will set the effective date for the new standard when considering this feedback, but no target date is given.

Comments

The revised exposure draft does go some way to meet concerns expressed about the 2012 exposure draft.

For instance, as for the accounting treatment of lease expenses, the revised exposure draft now has a clear distinction between most real estate and non-real estate leases with most real estate leases showing lease expenses as an operating expense on a straight line basis.

General Data Protection Regulation

The draft General Data Protection Regulation (the Regulation) is the centrepiece of a new legal framework which lays the foundation for the Digital Single Market. It will replace and repeal the current Data Protection Directive.

The draft Regulation proposes to introduce a much more stringent data protection regime in the EU. Key provisions include much stricter data security provisions, personal data breach notification, mandatory data protection officers for businesses employing more than 250 employees, new data subject rights and, for the first time, obligations for data processors.

The draft Regulation also proposes much stronger penalties for breach with fines of up to 2% of worldwide turnover.

Timing

At a conference at the end of April, Peter Hustinx, the European Data Protection Supervisor re-emphasised that, whilst there would be a postponement, he was looking forward to seeing a final draft of the Regulation agreed during the winter of 2013-14.

Comments

This year has seen further developments in the progress of the draft Regulation. In January 2013, the European Parliament Committee on Civil Liberties, Justice and Home Affairs (the LIBE Committee) published a series of proposed amendments to the draft Regulation. Many of these have resulted from intense lobbying by various business interests. The LIBE Committee had originally intended to pass a final resolution on the draft Regulation in late April 2013. This has now been postponed to enable it to fully consider the amendments.

The draft Regulation is expected to introduce significantly higher data protection standards and sanctions than currently provided in the Data Protection Directive. Fund managers will be keen to track the development of this draft Regulation which will have repercussions for all personal data held and processed by them. The draft Regulation will be particularly relevant to fund managers in relation to:

- customers and investors (both know your customer and in respect of marketing);
- employees; and
- any third parties who process personal data on a fund manager's behalf.

LEGAL DEVELOPMENTS – PLANNING AND DEVELOPMENT

Rights of light consultation paper

On 18 February 2013, the Law Commission published a consultation paper making recommendations for the reform of the law on rights of light. The Commission is proposing the following changes:

- Prescription to be abolished as a way of acquiring a right of light. This reform will not affect rights of light which have already been acquired, but in the future it would no longer be possible to acquire new rights of light by 20 years' enjoyment of light.
- A statutory test, setting out the criteria the court should take into account when deciding whether to award damages for an actionable breach of a right of light instead of an injunction requiring a developer to scale back a building which infringes that right.

Timing

The consultation formally closed on 18 May 2013, although the Law Commission has indicated that it will consider late consultations.

Comments

The perceived dampening effect that rights of light have had on development has been a bone of contention for a number of years and, in particular, since the 2010 case of HXRUK (CHC) Ltd v Heaney, where the High Court ordered a developer to scale back a completed development which infringed a right of light to an adjoining building.

Developers are concerned that those with a right of light can exercise a significant and disproportionate degree of control over what can be done on neighbouring land; often demanding premiums which bear no resemblance to their actual loss, in return for agreeing to release rights of light. The Law Commission's consultation is an opportunity for stakeholders to have their say in how the law should change.

If the Law Commission recommendations are eventually enacted, there has been some debate as to whether or not they do have the potential to be transformative, or if in fact they will have very little impact on how rights of light are enforced. For example:

continued

Rights of light consultation paper (cont'd)

- A statutory notice procedure to be used by developers which would require someone with the benefit of a right of light to state within four months whether they would seek an injunction to protect their light and a further four months within which to issue court proceedings to protect their right.
- Extending the power of the Lands Chamber to enable it to extinguish existing rights of light which are obsolete or have no practical benefit.

The Law Commission also sought views on additional areas where it currently has proposed no change. For instance, whether the current law on damages for infringing a right of light should be reformed. This is currently based on what 'feels right', which is usually a payment of a share of the profits from the developer to the neighbour.

- The abolition of the future acquisition of rights of light seems radical. However, as existing rights of light will not be touched, current buildings which have a right of light will continue to be an issue for developers for generations to come.
- The decision as to whether to grant an injunction to prevent development which would infringe a right of light is within the discretion of the court, which makes it impossible to predict the outcome. The proposed statutory test which the court must apply when exercising this discretion is welcome, but arguably will not make the outcome any more predictable as the court will still retain its wide discretion.
- The statutory notice procedure has the potential to be most useful to developers as it forces a neighbour ultimately to issue proceedings to protect a right of light, rather than merely threaten to. However, the detail of how the procedure will work will be crucial. For example, if it is to be treated as a last resort as the Law Commission suggests, it will not assist developers to add another eight month delay to their development programme (and longer if proceedings are issued).

Community Infrastructure Levy (CIL)

The Planning Act 2008 and CIL Regulations 2010 introduced the CIL as a new charge that local planning authorities can levy on developments to contribute towards the cost of local, sub regional and larger infrastructure. The levy applies on an area-by-area basis.

Timing

A handful of authorities including the Mayor of London have so far introduced a CIL.

The Government has recently announced a proposed delay to the longstop date for authorities to introduce CIL. This is now proposed for April 2015 and will be a welcome change, although almost all authorities are expected to have a CIL in place before then.

Comments

The last year or so has been a busy time in relation to CIL with the Government having amended the CIL Regulations twice, including the welcome removal of the risk of double charging on section 73 permissions (which vary conditions on existing planning permissions). The Government is currently proposing a third round of changes to the CIL Regulations. The Government's guidance on CIL was also substantially re-written in April 2013.

Although the changes were necessary to remove uncertainties and the risk of unreasonable liabilities, they demonstrate that CIL legislation was not well thought through at the outset and along with further proposed changes, also risks causing confusion and uncertainty.

Anecdotal evidence to date indicates that London developments appear to be able to carry the additional liability arising from the Mayor of London's CIL, but the full effect of CIL has not yet been felt in London because only a few of the London borough councils have introduced their separate borough CILs that are payable in addition.

In the more challenging regional economies, there is a significant risk of CIL hitting the development industry and wider economy harder.

Growth and Infrastructure Act 2013

The Growth and Infrastructure Act 2013 contains provisions for promoting growth and facilitating the provision of infrastructure and related matters, and economic measures.

Timing

The Act received Royal Assent on 25 April 2013.

Some provisions are already in force, with one further provision due to come into effect on 25 June 2013. The others will come into effect at a time of the Government's choosing and through commencement orders.

Comments

The Act provides for a wide range of changes to the planning regime, all intended to help stimulate growth and facilitate the provision of infrastructure.

The main planning measures include the option to make planning applications directly to the Secretary of State when a local planning authority has been 'designated' as underperforming, broadening the powers of the Secretary of State to award costs between the parties at planning appeals, and allowing for the reconsideration of economically unviable affordable housing requirements contained in section 106 agreements.

The infrastructure changes include measures for variation of consents granted under the Electricity Act 1989 (i.e. the pre-Planning Act 2008 regime), and amendments to the scope of Nationally Significant Infrastructure to include significant commercial and business development.

LEGAL DEVELOPMENTS – ENERGY

CRC Energy Efficiency Scheme

The CRC Energy Efficiency Scheme (CRC) is about to undergo a number of changes in preparation for Phase 2.

Timing

The CRC Energy Efficiency Scheme Order bringing in these changes is due to be passed in June 2013.

Investors should be aware that the qualification year for Phase 2 ended on 31 March 2013. Based on data collected during the qualification year, participants in the scheme now have a window in which to register for Phase 2, opening on 1 October 2013 until 31 January 2014 (under current draft proposals).

Comments

The key changes that the new Order will bring in are as follows:

Qualification criteria – only electricity through settled half hourly meters will be assessed (rather than all types of half hourly meter). The qualifying amount will remain at 6,000MWh.

Supply rules – the rules have been tightened up, so that an organisation will be responsible under the CRC for energy supplies that it received or energy supplies 'made at its direction'. There need not be a transfer of payment for such supply. This will make it harder for organisations to claim 'unconsumed supply'.

Landlord definition – the landlord/tenant rule will be disapplied in respect of ground lease arrangements where the minimum construction lease duration period is 30 years. It was previously 40 years. Otherwise, however, the landlord/tenant rule will continue unchanged.

Reduction in the number of fuels – the number of fuels covered under the scheme will be reduced to two – electricity and gas (gas for heating purposes only). It previously included gas-oil (diesel) and kerosene (for heating purposes only). This will help reduce administration costs but could create some perverse incentives on fuel switching.

continued

Removal of the 90% applicable percentage – the 90% rule and associated compliance activities will be removed but there will be a 2% de minimis on gas (for heating) introduced so that organisations with very low gas consumption do not need to report this and buy allowances for gas emissions for the rest of the phase. For many, this will be a welcome simplification but for some, with more complex fuel purchasing arrangements, this could significantly increase their reportable emissions.

Treatment of trusts – rules to determine where CRC responsibility should lie in relation to the treatment of trusts that hold real property will be implemented. However, trusts that do not have a majority beneficiary will be required to aggregate with their trustee or operator for qualification purposes only (and then could disaggregate).

Performance League Table – the Performance League Table will be abolished but the Environment Agency will continue to publish the aggregated participants' energy use and emissions data.

Energy Performance of Buildings (England and Wales) Regulations 2012

The Energy Performance of Buildings (England and Wales) Regulations SI 2012/3118 aimed to consolidate the Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations, and its subsequent amendments.

The following requirements have been introduced:

- Property advertisements must include details of the energy performance certificate (EPC) rating where available.
- Display energy certificates (DECs) are required in public buildings larger than $500m^2$ that are frequently visited by the public.
- An EPC must be displayed in commercial premises larger than 500 sq m that are frequently visited by the public.
- The content of the EPC is to be improved by including a list of energy efficiency improvements that could be carried out and providing consumers with information on this.

'Gold-plating' (meaning going beyond the minimum requirements) has also been removed, by extending the list of buildings exempt from the requirement to have an EPC.

Timing

The Energy Performance of Buildings (England and Wales) Regulations came into force on 9 January 2013.

Comments

The key implications are:

Property advertisements – for buildings offered for sale or rent after 9 January 2013, it is no longer necessary to attach a copy of the EPC's first page to any written particulars. Instead, advertisements in commercial media for the sale or rent of buildings (both commercial and residential) must give the asset rating from a valid EPC.

'Commercial media' is undefined but is likely to include the internet, newspapers, magazines and sales particulars.

DECs – institutions 'providing public services to a large number of persons' no longer need to display a DEC, but may need to display an EPC instead. Only buildings of the relevant size that are occupied by a public authority need a DEC.

The size threshold has reduced to buildings with a total useful floor area over 500 sq m. From 9 July 2015 this drops again to a floor area of between 250 sq m and 500 sq m.

Commercial premises – where a building is larger than 500 sq m, not a dwelling and frequently visited by the public it must display its EPC in a prominent place, clearly visible to members of the public.

The term 'frequently visited by the public' is undefined. The guidance indicates that members of the public must visit on a daily or near daily basis and have an express or implied licence to enter.

Exemptions – more types of building are now exempt from the EPC obligations in Part 2 of the Regulations. Existing exemptions have also been slightly rewritten and it is advisable to check the wording of any exemption before relying on it.

Minimum EPC rating for domestic and non-domestic lettings

The Energy Act 2011 contains a provision that, when implemented, promises to prevent landlords from letting premises that fall below a specified EPC grade (expected to be F or G) unless the landlord has carried out the maximum package of measures that can be funded through a specified financial arrangement (e.g. Green Deal). This will apply to both commercial and residential property.

The Energy Act 2011 also includes provisions to ensure that private residential landlords will be unable to refuse a tenant's reasonable request for consent to energy efficiency improvements where a finance package, such as the Green Deal and/or the Energy Company Obligation (ECO), is available.

Timing

Bar on letting domestic or non-domestic premises below the minimum EPC rating is due to come in from April 2018.

Bar on not refusing tenants' reasonable requests for energy efficiency improvements is due to come in from April 2016.

Comments

The minimum EPC rating is, potentially, a ticking time-bomb in the real estate industry. Estimates place something in the order of 20% of current building stock at the 'F' and 'G' ratings.

Some flexibility is to be provided for (e.g. for listed buildings) and some exceptions made (to be confirmed). Sanctions for failure to comply have also to be confirmed.

However, these new powers provide a clear rationale for assessing portfolios, identifying properties 'at risk' and planning for energy efficiency retrofit (where possible).

Landlords should begin to evaluate their portfolio, identify what energy efficiency measures can be installed, when this should be carried out and what government funding is available.

These provisions also highlight the need for considered and deliberate decision-making on the exercise of the landlord's right to approve tenant improvements and right to require re-instatement, which may go to the EPC rating of the premises.

The Green Deal and ECO Funding

The Green Deal is an innovative financing mechanism that lets people pay for energy-efficiency improvements through savings on their energy bills.

The Green Deal applies to both the domestic and non-domestic sector. It replaces current policies such as the Carbon Emissions Reduction Target (CERT) and the Community Energy Saving Programme (CESP).

Alongside the Green Deal, the Energy Company Obligation (ECO) will provide additional support for low-income households and difficult-to-treat properties.

Timing

The Green Deal Framework (Disclosure, Acknowledgment, Redress etc.) Regulations 2012 came into force on 28 January 2013.

Comments

Green Deal financing is recovered through a standing charge added to the electricity bill. It is payable no matter how much electricity is used in the property and by whoever is the electricity bill payer. During void periods, the landlord is responsible for the repayments. On changes of tenant, the incoming tenant becomes responsible. It is not automatically discharged when the owner or tenant who took out the Green Deal financing moves out.

Under section 12 of the Energy Act 2011, an existing Green Deal must be disclosed at the time of a sale or lease of a property.

The Framework Regulations set out the duty on those selling – the estate agent or the private seller or the landlord – to disclose to any viewer of the property the fact that the property is subject to the Green Deal.

The impact on property values of having a Green Deal debt is as yet unknown.

The Renewable Heat Premium Payment and Renewable Heat Incentive

The Renewable Heat Incentive (RHI) provides a tariff-based income for all renewable heat generated and used within a property, and any heat exported to a heat network, should there be one available.

Currently, the RHI is open to parties in the non-domestic sector which includes industrial, commercial, public sector and not-for-profit organisations with eligible installations. DECC has announced that it intends to extend the RHI to the domestic sector.

Until the RHI is launched for single domestic properties, landlords are able to access the Renewable Heat Premium Payment (RHPP) scheme. The RHPP is a one-off grant designed to help towards meeting the costs of installing renewable technologies.

Timing

There are two phases to the introduction of the RHI. See the comments box for details.

Comments

DECC is currently consulting on the detail of the domestic scheme and has proposed that, in order to be eligible for the RHI, properties will have to reach certain basic energy efficiency standards.

DECC has announced that it will be expanding the RHI scheme to cover additional technologies and the final details are expected in summer 2013 with the scheme being opened for payment from spring 2014.

There are two phases to the introduction of the RHI:

- Phase 1: the introduction of the RHI for non-domestic installations. This has already been introduced and is being administered by Ofgem.
- Phase 2: the domestic element of the RHI, is expected to be introduced in spring 2014 following the consultation published in September 2012 and more recently the UK Government Heat Strategy and will be administered by DECC.

LEGAL DEVELOPMENTS – REGULATORY

Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD seeks to regulate the private fund industry: hedge, private equity and real estate funds. However, the scope of the AIFMD is very broad. It will catch the managers of any collective investment undertaking that raises capital from a number of investors and invests it in accordance with a defined investment policy (other than Undertaking for Collective Investment in Transferable Securities (UCITS funds), which are regulated separately) and certain exempted arrangements in the AIFMD.

Alternative investment fund managers (AIFMs) of alternative investment funds (AIFs), as they are known, will need to be authorised and will face increased regulation, supervision and disclosure requirements.

The AIFMD will impact firms managing or marketing any AIF in the EU. Only AIFs established and managed outside the EU and not marketed in the EU will be unaffected by it.

The AIFMD will be implemented into UK law through the Alternative Investment Fund Managers Regulations 2013 and amendments to the FCA Handbook. The FCA's proposed rules can be found in FCA Policy Statement 13/5. The new rules apply from 22 July 2013.

Timing

The deadline for national implementation of AIFMD is 22 July 2013. Parts of AIFMD will impact non-EU AIFMs and certain EU AIFMs from this date.

However, under the legislation implementing the AIFMD in the UK, certain AIFMs will not have to comply with the AIFMD until the earlier of (i) the date they are authorised under the AIFMD; and (ii) 22 July 2014.

This position could be different in other EU member states.

Comments

Managers of real estate funds will be affected by the AIFMD and should already be taking steps to ensure they are in a position to comply with it. The AIFMD can apply to any form of vehicle, including listed and unlisted entities and bodies corporate.

There are a number of transitional provisions which could take existing arrangements out of the AIFMD. These broadly apply if the fund or venture is being wound down or is fully invested.

In the case of REITs, the final guidance published by the Financial Conduct Authority (FCA) states that there is no presumption either way that a REIT is in or out of scope. You must look at the underlying substance of the arrangements to see if they fall within the AIFMD or not. REITs should carefully consider whether they are in scope or not and it would be prudent to seek advice on this point.

On joint ventures, the FCA offers some helpful pointers on the features of a joint venture. The FCA also helpfully notes that joint ventures structured as limited partnerships, where the limited partners cannot directly manage the business of the venture, can still be joint ventures and, therefore, likely to not be AIFs.

A lot of uncertainty still remains, not least because different EU member states appear to be adopting different approaches. AIFMs with a pan-European business will need to be especially cautious.

Those entities which are AIFMs under the AIFMD will also be financial counterparties under EMIR (for which, see under Legal Developments – Finance below). This will have an additional cost and compliance impact.

Financial Regulation Reforms in the UK

The Financial Services Authority (FSA) was abolished on 1 April 2013 and replaced with three new regulatory bodies:

- The Financial Policy Committee (FPC): this will form part of the Bank of England and be responsible for macro-prudential regulation – broadly, identifying potential threats to the UK's financial stability and acting to prevent another financial crisis.
- The Prudential Regulation Authority (PRA): this will be responsible for the prudential regulation of banks, insurers and the larger investment firms. It will seek to ensure they hold enough capital and liquidity and could have an orderly wind up if the need ever arose.
- The Financial Conduct Authority (FCA): this is the successor body to the FSA. It is responsible for the prudential regulation of all other authorised firms, as well as for regulating the conduct of all authorised firms.

Timing

The new regime came into effect on 1 April 2013.

The regulation of consumer credit will transfer from the Office of Fair Trading (OFT) to the FCA on 1 April 2014.

Comments

The most significant impact of the new regime will be on dual-regulated firms (those authorised by the PRA and subject to conduct regulation by the FCA). For other firms, it should be largely the same, only more active and more intrusive.

Authorised firms should have already updated their business stationery, template contracts and other documentation to refer to the new regulator(s). There could also be other changes, for example to approved persons and regulatory contacts.

The new regulators will also have powers over the parent companies of authorised firms, such as information powers and the ability to direct the parent company to transfer capital to the authorised firm.

The transfer of consumer credit from the OFT to the FCA will impact firms who offer second charge mortgages. Whilst the substance of the consumer credit regime should not change, the FCA will have increased powers over lenders' conduct and much wider enforcement powers.

Solvency II (and the review of the IORP Directive)

Solvency II is a fundamental review of the capital adequacy regime for the European insurance and reinsurance industry. It deals with the amount of capital which EU insurance companies must hold in order to reduce the risk of insolvency. Solvency II brings in capital requirements for insurers similar to those imposed on banks in Basel III.

There are different capital requirements according to the asset types involved. The higher the perceived risk of an asset class, the more capital the insurer needs to set aside to ensure that, if its value falls, the insurer's ability to cover all its notional liabilities to policyholders is not affected.

The European Insurance and Occupational Pensions Authority (EIOPA) is consulting on its proposed interim measures guidelines, which it proposes should be adopted by national supervisors (in the UK, the Prudential Regulation Authority) from 1 January 2014. National authorities which do not comply will have to provide reasons for non-compliance, as well as producing a progress report on an annual basis (the first of which is expected by 28 February 2015).

There were also proposals for the next version of the Occupational Pensions Directive (IORP Directive) to apply Solvency II-style measures to UK pension schemes. However, in May 2013 the European Commission announced that a revised IORP Directive will not cover the issue of solvency rules for pension funds.

Timing

Solvency II was adopted in November 2009. The target date for implementing Solvency II has been postponed to 1 January 2014. However, this is expected to be put back again, with full implementation expected in 2015 or 2016. The European Parliament is expected to consider the Omnibus II Directive (which will amend Solvency II) in October 2013.

The EIOPA consultation closes on 19 June 2013. The finalised text is expected in autumn 2013.

Comments

Two main concerns have been raised in respect of real estate investments:

1. The proposed 25% capital requirement for insurance companies investing in real estate is too high and a 15% pan-European capital charge would be more realistic, with the possibility of a +/- 10% dampener.
2. The fact that there is no dampener for the real estate capital charge could lead to a requirement for additional capital in a falling property market and/or insurers having to sell property to maintain adequate capital ratios, which could then trigger further falls in property values.

The announcement that a revised IORP Directive will not now deal with issues of solvency will be welcome in the industry: there had been concern that new, more stringent, funding obligations would be introduced. However, Commissioner Michel Barnier stated that the issue of solvency rules for pension funds remains 'an open issue' and that 'the situation should be re-examined once we have more complete data.'

Restrictions on the retail distribution of UCIS and close substitutes

The FCA has published its policy statement and rules in relation to unregulated collective investment schemes (UCIS) which will ban the promotion of UCIS to the vast majority of UK retail investors. UCIS are broadly defined but will generally include investment funds such as private equity, real estate, debt, hedge and infrastructure funds. Other arrangements which do not have typical fund characteristics could also be caught so each investment should be considered on a case by case basis.

The changes mean that promotion of riskier and more complex fund structures will be limited to sophisticated investors for whom these products are suitable. The ban follows extensive work undertaken by the FSA and subsequently the FCA, which found that only one in every four advised sales of UCIS to retail customers was suitable and that many promotions breached the existing UCIS marketing restrictions.

Timing

The new rules take effect from January 2014 although the FCA has said that firms may wish to comply with them sooner, in particular given the 'significant risk of inappropriate or unsuitable sales to ordinary retail investors, which these rules seek to address.'

Comments

The new policy will extend the products which are caught to include the following:

- units in qualified investor schemes;
- traded life policy investments; and
- securities issued by special purpose vehicles pooling investments in assets other than listed or unlisted shares or bonds.

The FCA has confirmed that the following products will be outside the scope of the marketing restrictions:

- securities issued by special purpose vehicles pooling investments in listed or unlisted shares or bonds;
- exchange traded funds;
- overseas investment companies that would meet the criteria for investment trust status if based in the UK;
- real estate investment trusts; and
- venture capital trusts.

Firms should review their procedures to ensure that they are compliant with the new rules, focussing in particular on those products which were not caught by the previous UCIS marketing restrictions.

US Investment Advisers Act

The US Investment Advisers Act was amended on 21 July 2010 as part of the Dodd-Frank reforms. The amendments mean that many investment advisers to private investment funds will have to register with the US Securities and Exchange Commission (SEC). This applies even if they are already authorised by the FCA or another regulator. Record keeping and reporting obligations for registered and certain unregistered advisers will also increase.

The provisions may apply to some non-US real estate fund managers – where they have an office or presence in the US at which they provide 'investment advisory services', or have US investors or US entities they manage and where they cannot rely on an exemption.

Registrations are published on the SEC website and are therefore publicly available.

Timing

Investment advisers were required to register (by submitting a Form ADV) with the SEC by 30 March 2012 and are required to update their registration filing on an annual basis, by 90 days after the end of the investment adviser's fiscal year.

Those relying on certain exemptions such that they are 'exempt reporting advisers' (ERAs) had only to file an abbreviated Form ADV by 30 March 2012.

Comments

If an investment adviser has no place of business in the US, then it will not have to register, but may need to file as an ERA. A real estate adviser may be able to avoid filing as an ERA if either: (1) it does not advise any US funds or US investors (or the assets under management attributable to such US investors are less than $25m in total); or (2) its US investors are not in 'private funds'.

A real estate fund will generally not be a 'private fund' where its assets are not 'primarily' securities. 'Securities' includes shares but does not include direct real estate. It may include real estate held through joint ventures (generally either a controlling interest in a joint venture or a manager or a general partner interest is unlikely to be considered 'securities'). Real estate held through wholly-owned or majority-owned subsidiaries, in corporates or other vehicles, is unlikely to be a security (and therefore not a 'private fund'). Mortgages secured by real estate may also not be a 'private fund'.

The analysis is highly fact-intensive – however, if a fund only holds real estate through wholly-owned subsidiaries or majority owned subsidiaries that it controls, this is unlikely to be a 'private fund'.

US Regulatory Reform – the Volcker Rule

The Volcker Rule amends the Bank Holding Company Act. It prohibits any 'banking entity' from sponsoring and/or acquiring or retaining an ownership interest in a 'covered fund'. A 'banking entity' includes any insured depository institution (for instance, a bank holding company), any foreign banking organisation that is subject to the Bank Holding Company Act (for example, a foreign bank that maintains a branch or agency in the US) and any subsidiary or affiliate of one of these entities. There is an exemption that permits foreign banking organisations to invest in a foreign fund that meets various requirements.

Investment advisers that are not banking entities or affiliated with a banking entity are not subject to these rules. However, these rules may mean certain investors cannot invest in certain funds.

Timing

The Volcker Rule came into force on 21 July 2012. However, the deadline for compliance (including for divestiture of investments that are not in compliance with the Volcker Rule) is 21 July 2014. This can be extended by the Federal Reserve Board.

Several US agencies are engaged in writing the specific rules that will implement the Volcker Rule.

Comments

Fund managers that are banking entities or affiliates of banking entities must determine whether or not their fund sponsorship activities will be limited by the Volcker Rule. More generally, even if a fund manager is not subject to the Volcker Rule, if it intends to market a fund to US investors or to make US investments, it should consider whether any of its investors may be subject to the Volcker Rule.

Subject to any applicable exemptions, an investor who is subject to the Volcker Rule will not be entitled to invest if the fund engages in certain investments or other activities in the US or where either:

- the fund has already been marketed in the US; or
- the fund already has US investors.

Jumpstart our Business Startups Act (JOBS Act)

The US has much more stringent rules regarding private placements and public offerings than the UK. As a general rule, marketing an alternative investment fund to US investors may require registration under the US Securities Act 1933 unless the offer and sale is exempt from registration. There is a safe harbour which avoids the need for registration, known as Regulation D – a condition of which is that the fund and all persons acting on its behalf do not 'generally solicit' investors during the marketing period.

This approach is widely used by alternative investment funds when marketing to US investors and it means that they cannot use any public medium or forum to promote the offering.

The JOBS Act requires the SEC to eliminate the ban on general solicitation, so that any advertising or other form of publicity can be used to promote an offering. This would mean that the fund could be referred to in press releases, press articles, websites or public forums.

Timing

The period of public comment for these new rules ended in autumn 2012. The proposals are expected to be implemented in 2013 and once final rulemaking is produced by the SEC.

Comments

Until the SEC's rulemaking is finalised, the current ban on marketing for US private placements remains in place.

The SEC proposes two provisos to remove the prohibition on general solicitation:

1. all investors are (or are reasonably believed to be) 'accredited investors' (see below for what these are); and
2. the fund sponsor takes reasonable steps to verify that the purchasers of interests are 'accredited'.

The second limb of these proposals will be the main practical change: the need for the fund sponsor to verify 'accredited investor' status. It will be crucial for a fund sponsor to keep its verification records. The SEC states that verification would be an objective determination, based on the particular facts and circumstances of each transaction. The SEC has also given some guidance on this process, including looking at the nature of the purchaser and the nature of the offering.

'Accredited' investors are those with individual net worth (or jointly with a spouse) over US$1m (excluding the value of the primary residence) or individual income over $200,000 (or joint income if over $300,000). For entities, it is either where all of the equity owners are accredited investors or a corporate or trust not formed for the specific purpose of acquiring interests in the fund and with total assets of over $5m.

US commodity pool rules

Changes under the Commodity Exchange Act in the US governing 'commodity pools' mean that a wide range of non-US property enterprises with US investors and using derivatives and swaps will become regulated by the US Commodity Futures Trading Commission (CFTC).

For those private funds affected, the general partner and manager, unless they can rely on one of the exemptions, will be required to register with the CFTC, as a commodity pool operator or a commodity trading adviser respectively.

Even if the de minimis exemption applies (see comments) there are annual filing requirements with the CTFC.

Timing

Compliance for those active in the swaps market: 11 March 2013.

Compliance for others: 10 June 2013.

Comments

A US Treasury Department final determination issued in November 2012 means that managers and general partners of private funds that trade foreign exchange forward contracts and foreign exchange swaps, but not other swaps or instruments that qualify as commodity interests for CFTC purposes, will no longer be required to register with the CFTC.

Another useful exemption for real estate funds and companies is the de minimis exemption. One requirement of this exemption is that there is no marketing to the public in the US. This exemption is only from CFTC registration and not from other US rules under Dodd-Frank or the Volcker Rule or from central clearing and margining.

General partners and fund managers relying on this exemption will have to file an initial notice of claim with the National Futures Association and will also have ongoing compliance requirements.

LEGAL DEVELOPMENTS – FINANCE

European Market Infrastructure Regulations (EMIR – OTC Derivatives)

EMIR introduces a clearing obligation that will apply to those over the counter (OTC) derivative contracts which the European Securities and Markets Authority (ESMA) considers should be centrally cleared through authorised central counterparties (CCPs). If a real estate business is a 'financial counterparty' (or enters into OTC derivatives above certain thresholds and becomes a clearing 'non-financial counterparty') it will be required to clear trades in those contracts through a CCP. Those trades will need to have 'highly liquid' collateral (not real estate) posted. There will be detailed conduct of business requirements for CCPs.

Different rules apply where OTC derivative contracts are not subject to mandatory clearing by a CCP. Businesses caught will need to put risk management techniques in place, designed to manage operational and credit risk, including daily marking-to-market of non-centrally cleared derivative positions, increased use of electronic confirmation and increased transparency requirements. The exact requirements will depend on whether a firm is classed as a 'financial counterparty' or a 'non-financial counterparty' and the level of OTC derivative activity.

EMIR also requires details of both OTC and on-exchange derivatives to be reported to a trade repository.

Pension schemes are exempt from a clearing obligation for a period of three years, extendable by another two years plus one year, subject to reports justifying the deferrals.

Timing

EMIR enters in force on a staged basis. The first requirements, relating to timely trade confirmations for non-centrally cleared derivative positions and certain notifications being made by non-financial counterparties, entered in force in March 2013.

The next risk mitigation techniques for non-centrally cleared trades will enter in force in September 2013.

Reporting requirements for credit and interest rate derivatives is also currently scheduled to begin in September 2013, with reporting for all other derivatives expected in January 2014.

Clearing through a CCP, and certain other requirements including providing collateral for non-centrally cleared trades, are expected towards the end of 2014/early 2015.

Comments

EMIR will increase the cost of debt without any apparent benefit, as real estate investors generally use derivatives and swaps (e.g. hedging interest rate and currency risks) to reduce risk rather than for speculative purposes.

For a real estate sector business which is caught by EMIR:

- standardised swap activities (determined by ESMA) may need to be cleared through CCPs, with appropriate liquid collateral (real estate does not currently count) and reporting; and
- for swaps that are not cleared through a CCP, it will have to have risk management procedures in place, potentially including the marking-to-market of outstanding contracts on a daily basis.

In relation to clearing, one important area is who is a 'financial counterparty' and therefore within the scope of the more detailed requirements of EMIR. This includes for these purposes AIFs managed by an AIFM within AIFMD, as well as banks and other financial institutions.

Basel III

On 16 April 2013, the European Parliament adopted a legislative package known as CRD IV, which implements Basel III. The legislation comprises:

- the Capital Requirements Directive (CRD); and
- the Capital Requirements Regulation (CRR).

CRD IV essentially rewrites the prudential framework for banks incorporating Basel II (credit risk rules), Basel 2.5 (new trading book rules) and market risk amendments to Basel I. This exercise has been undertaken to accomplish maximum harmonisation of rules through the CRR, which is directly applicable and does not need to be transposed into national rule books. The UK has decided to draw on the carve-out in the CRD IV text to set higher capital requirements for ring-fenced banks under the Independent Banking Commission requirements.

UK banks (including subsidiaries owned by non-EU banks) need to deploy firm-wide initiatives to ensure that they comply with the extensive supervisory regulatory framework which has been introduced by CRD IV.

Timing

Implementation is to commence from 1 January 2014 (if the legislation is published in the Official Journal before 1 July 2013). If published after 1 July 2013, implementation will commence from 1 July 2014.

Comments

Under the novel 'twin peaks' regulatory framework in the UK, the Prudential Regulation Authority (PRA) has assumed responsibility for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA intends to launch two consultations on the implementation of CRD IV in the UK. The first of these will be published before September 2013 and will set out changes to the PRA rules to reflect the CRR and to implement the rules that have to be transposed into the PRA rulebook. The PRA has confirmed that the CRR will, in substance, replace most of the current capital requirements in the PRA rulebook.

In brief, CRD IV seeks to:

- enhance the quality and quantity of bank capital;
- allow deductions directly from core tier 1;
- simplify capital structures (fewer tiers and removing gearing);
- introduce a leverage ration as a backstop to risk-based capital;
- introduce new capital buffers;
- implement the liquidity regime (namely net stable funding ratio and liquidity coverage ratio); and
- improve disclosure frameworks.

Slotting

The FSA (now the FCA) confirmed in January 2013 that UK banks would be required to apply its slotting guidelines to their commercial property loan books.

Banks subject to the rules must categorise all current and performing property loans to one of the five 'buckets' listed below which carry different risk weights. The respective risk weights determine how much capital is to be held against potential losses on each loan.

Remaining maturity of loan – less than 2.5 years

Category	Risk weight
Strong	50%
Good	70%
Satisfactory	115%
Weak	250%
Default	0%

Remaining maturity of loan – equal or more than 2.5 years

Category	Risk weight
Strong	70%
Good	90%
Satisfactory	115%
Weak	250%
Default	0%

Based on these risk weights and the 9% equity ratio specified in the Basel III banking code, banks will be required to allocate £4.50 for every £100 of their best performing loans (9% x 50%) with less than 2.5 years to maturity.

Timing

The FCA has not set a strict deadline for compliance with the slotting rules and is currently working with banks to implement the requirements.

Comments

The resultant economic burden of bolstering capital reserves will of course be borne by banks and borrowers active in the commercial real estate market. Banks will no doubt consider the expediency of lending to assets in the heavier risk-weighted categories and generally review their lending exposure to commercial real estate.

Borrowers in the real estate sector should expect the cost of real estate borrowing to increase as banks adjust to the prescriptive demands of the slotting regime. This is clear from real estate loan documentation, where a number of banks have introduced margin ratchets, which are triggered on the occurrence of an event of default. The ratchet will apply even if a lender has decided against accelerating a loan (accelerating the loan would place that loan into the 'default' or 'weak' category). Such practices will culminate in greater interest payments on loans.

It is important to note that banks will only be able to escape the ambit of the slotting regime if they can show that the risk levels of the loan holdings are 'accurate and conservative'.

The fact that the slotting regime only applies to UK banks has enhanced the interest of non-bank lenders, such as debt funds and insurance companies, who are expected to expand their commercial real estate backed loan books.

Shadow Banking

The European Commission published a green paper in 2012 which outlined a raft of shadow banking activities (securitisation and securities lending and repo) and entities which form the basis of the Commission's focus in this area. These entities are:

- finance and securities firms engaged in providing credit or credit guarantees;
- special purpose vehicles that perform liquidity and/or maturity transformation. This category also includes securitisation vehicles such as asset-backed commercial paper conduits, special investment vehicles and other special purpose vehicles;
- money market funds and other types of investment funds or products with deposit-like characteristics;
- investment funds, including exchange traded funds that are leveraged or issue credit to other entities; and
- insurance and reinsurance undertakings that issue or guarantee credit products.

The European Parliament's Committee on Economic Affairs' (the Committee) draft report on shadow banking contains a number of interesting proposals, including:

- the creation of a central EU database on euro repo transactions. The Committee has called upon the Commission to issue a legislative proposal to establish a database by the end of 2013; and
- a proposal for shadow banking entities with bank sponsors or links to banks to be included on the banks' balance sheets for prudential consolidation purposes. The Committee has invited the Commission to examine ways of ensuring that shadow banking entities that are not consolidated from an accounting standpoint are consolidated for prudential consolidation purposes.

Timing

Calls for a detailed policy framework in this domain continue to gain traction with the G20 Finance Ministers. It will be interesting to see how regulators react to the Financial Stability Board's (FSB) final recommendations once they are published in September 2013.

Comments

On a global level, the FSB has been working alongside the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions on developing a policy framework for the shadow banking system.

The FSB launched a consultation on strengthening oversight and regulation of shadow banking in November 2012. The consultative document sets out a series of policy recommendations which were reviewed by the G20 Finance Ministers and Central Bank Governors at a meeting in November 2012.

In its consultation document, the FSB notes that repo activity can lead to the build-up of excessive leverage and liquidity transformation outside the boundaries of prudential liquidity and capital regulation. The FSB has therefore set a policy goal of ensuring there is adequate transparency to regulators and to limit risks to financial stability from excessive leverage and liquidity transformation.

In practice, this is likely to take the form of more rigorous reporting obligations on financial institutions that are active in the securities lending and repo markets.

The FSB would, among other recommendations, also like to subject cash collateral reinvestment to regulatory limits on liquidity and leverage risks.

High Value Residential Property (15% SDLT band, ATED, CGT extension)

15% SDLT band

The Government introduced a 15% stamp duty land tax (SDLT) rate for acquisitions with an effective date on or after 21 March 2012 by non-natural persons of UK residential property for consideration exceeding £2m.

Draft legislation to be included in the Finance Bill 2013 will introduce reliefs which, subject to a three-year clawback period, reduce the 15% rate to seven% for acquisitions by property rental, development and trading businesses. The reliefs will apply to transactions with an effective date on or after the date of Royal Assent of the Finance Bill 2013.

Annual Tax on Enveloped Dwellings (ATED)

From 1 April 2013 the Government introduced an annual tax payable by companies owning UK residential property with a value exceeding £2m. The tax starts at £15,000 and increases depending on the value of the property.

Reliefs are available where, amongst others, the property is purchased as part of a property rental or development business.

CGT extension

Since 1 April 2013 capital gains tax (CGT) has been extended to include disposals of UK residential property for consideration exceeding £2m by non-natural persons who are non-UK resident. Those caught include companies, trustees and collective investment vehicles. Partnerships remain transparent for CGT purposes.

Reliefs are available largely on the same terms as the ATED reliefs.

Timing

The higher rate of SDLT has applied since 21 March 2012. Unfortunately the reliefs to be introduced will only take effect from the date of Royal Assent of the Finance Bill 2013.

ATED has been in force since 1 April 2013.

The CGT extension has been in force since 1 April 2013.

Comments

The Government views these three measures as a package to discourage ‘enveloping’ UK residential property and to counter avoidance by the economic owners of high-value residential property.

Despite the potentially wide ranging scope of these measures, the reliefs to be introduced will mean that the taxes are unlikely to have a significant impact on property rental or development businesses.

General Anti-Abuse Rule (GAAR)

The GAAR seeks to block abusive tax schemes, with the aim of deterring taxpayers from entering into, and thereby deterring the promotion of, abusive arrangements.

If a taxpayer enters into an abusive arrangement the GAAR will operate to counteract the advantage sought by making a just and reasonable adjustment.

A taxpayer should not fall foul of the GAAR if it takes reasonable, rather than ‘abusive’, tax decisions. In addition, the GAAR will not apply if the arrangements adopted are in line with established practice, and/or are consistent with the underlying policy.

Consequently, a taxpayer will remain free to take the tax consequences of a transaction into account when choosing how to structure a transaction. Seeking tax advice in order to procure a tax effective result will not automatically trigger the GAAR.

However, if a taxpayer adopts convoluted structures in order to procure tax results that are contrary to the intended consequences of the law, it is likely that the GAAR will be in point.

Timing

The GAAR will apply to any arrangements entered into on or after the date of Royal Assent of the Finance Act 2013.

Comments

The GAAR serves to emphasise the Government's stance that aggressive tax avoidance will not be tolerated.

However, the GAAR is potentially wide reaching and it is concerning that the threshold for arrangements to be considered as ‘abusive’ remains unclear.

HMRC has released extensive guidance incorporating a whole series of examples of arrangements that would trigger the GAAR. These examples will be of little assistance in the case of novel transactions.

HMRC has acknowledged that standard tax planning combined with some elements of artificiality ‘may’ not be abusive.

Foreign Account Tax Compliance Act (FATCA)

FATCA is US legislation that seeks to combat the use of offshore accounts by US taxpayers to evade tax.

In brief, payments of US source income will be subject to a 30% withholding tax unless the receiving foreign financial institution (FFI) complies with FATCA by disclosing requisite information to the US Internal Revenue Service (IRS). The definition of an FFI is wide and, amongst others, includes banks, private equity funds, insurance companies and trust companies.

In an attempt to reduce the burden of compliance on UK companies, an agreement signed with the US enables UK companies to report to HMRC which will in turn pass the relevant information to the IRS. Provided the requisite information is provided to HMRC, UK FFIs will avoid the 30% withholding tax.

UK regulations are to be introduced requiring financial institutions to identify certain information using specified due diligence procedures and return that information annually to HMRC.

Timing

FATCA applies to withholdable payments from 1 January 2013. There are further phases of legislation introducing additional measures to be implemented over a number of years.

The UK FATCA regulations will take effect on the date of Royal Assent of the Finance Act 2013.

Comments

The FATCA legislation is lengthy, complex and currently somewhat transient. As a result, practitioners are inevitably facing difficulties in identifying the implications of what is essentially a US law for UK entities.

The UK regulations go someway to alleviate the burden of compliance with FATCA on UK FFIs, however going forward the implications of FATCA will need to be borne in mind by all FFIs receiving US source income.

Financial Transactions Tax

In February 2013, the European Commission released proposals for a financial transaction tax (FTT) to be introduced under enhanced co-operation in 11 EU members, including Germany, France and Spain. The aim of FTT is to raise revenue from the financial sector.

The detail of the FTT has not yet been finalised. However, it will be payable by all parties to a financial transaction either based in, or linked to, the EU countries within which it is to be introduced. A financial transaction includes transactions in shares and derivatives.

Timing

The FTT is intended to apply from 1 January 2014, although this timeframe is expected to slip.

The European Court of Justice is unlikely to hear the UK challenge to the FTT before 2014.

Comments

The UK is understandably concerned by the extraterritorial provisions of the proposed FTT and the effect on the City. It seems that the UK is not alone in its concerns, with the US also expressing concerns as to the far reaching nature of the FTT.

As drafted, the proposals have the potential to impact all parties to financial transactions with a link to one of the 11 countries.

The UK Government has recently challenged the decision of the EU Council authorising the introduction of the FTT. The UK challenge is thought to be based on whether the extraterritorial effects of the proposed FTT are compatible with the enhanced co-operation procedure.

Tax and procurement

Suppliers tendering for Government contracts above £5m are now required to declare their tax compliance history as part of the public procurement process.

A supplier will be required to self-certify in the pre-qualification questionnaire that it has not had any 'occasions of non-compliance' taking place after 1 April 2013. Going forward, suppliers will need to certify that such is the case for the past six years or back to 1 April 2013.

An occasion of non-compliance includes:

- where a tax return is found to be incorrect as a result of a successful challenge by HMRC under the GAAR or the 'Halifax' VAT abuse principle;
- where a tax return is found to be incorrect due to a failed scheme which was or which should have been notified under Disclosure of Tax Avoidance Schemes; and
- where a supplier has been convicted for tax related offences or incurred a civil penalty for fraud or evasion.

If a supplier is unable to self-certify, it is open to the contracting Government department to exclude the supplier from the procurement process.

Foreign entities are only required to self-certify insofar as there are equivalent domestic tax rules.

Timing

The changes to the procurement process have applied to all Government contracts above £5m advertised since 1 April 2013.

Comments

The Government has confirmed that the self-certification process is an entity based approach. The contracting supplier is not required to self-certify on behalf of group companies or any sub-contractor. All parties to a joint venture must self-certify; in a partnership, self-certification does not extend to individual members.

This approach may encourage potential suppliers to operate through special purpose vehicles to avoid declaring occasions of non-compliance. The Government has reserved the right to review the policy within a year and will no doubt tighten up this approach should it be used as a means of circumventing the self-certification process.

Suppliers should bear in mind that even settlement of potential disputes by agreement with HMRC can result in an occasion of non-compliance.

SDLT transfer of rights

The Finance Act 2013 will introduce a new mechanism for calculating SDLT where a buyer transfers its rights under a contract for land prior to completion of a conveyance. Going forward, these are to be known as 'pre-completion transactions', defined as assignments and free-standing transfers. Novations are now specifically included.

In a bid to clamp down on SDLT avoidance structures, a buyer will now need to file a return and apply for relief in order to prevent a double charge to SDLT. A buyer will only be eligible for relief provided that the transfer does not form part of a tax avoidance scheme. This will allow HMRC both to monitor transactions and stamp out avoidance.

In the case of sub-sales, the new rules retain the requirement that the A–B and B–C transactions must be substantially performed or completed at the same time and in connection with each other.

Timing

Changes are due to take effect on the date of Royal Assent of the Finance Bill 2013.

Comments

The legislation has been overhauled in an attempt to stamp out avoidance, although given the length and complexity of the legislation produced, it is doubtful whether this has been achieved.

When this legislation is coupled with HMRC's recent string of tribunal successes on SDLT avoidance schemes, it can be seen that the Government is taking a clear stance that SDLT avoidance will not be tolerated.

REITs investing in REITs

A package of measures are to be introduced to enable the income of UK REITs investing in other UK REITs to be treated as exempt.

The consequences of this are as follows:

- the property income distribution (PID) that a UK REIT receives from another UK REIT would be tax exempt;
- for the purpose of the balance of business test the investment by a REIT in another REIT will be included as an asset of the investing REIT's property rental business; and
- the investing REIT must distribute 100% of the PID it receives to its investors within 12 months of the accounting period in which it is received.

Timing

Changes are due to take effect on the date of Royal Assent of the Finance Bill 2013.

Comments

The proposed reforms are likely to have a positive impact on the REIT sector and will be welcomed by the property industry.

The key effects of the changes are likely to be as follows:

- since they offer potential for REITs to set up 'Sub-REITs', these may have differing exposures to property risk and property types which may be attractive to different classes of investor;
- new entrants may be encouraged to enter the REITs sector. New entrants can establish UK REIT vehicles to joint venture with existing REITs and benefit from increased tax efficiency; and
- the reforms to the tax treatment of REIT in REIT investment may encourage offshore unit trusts to move onshore.

Competition Law and Land Transactions

Following a referral by the Office of Fair Trading (OFT) to the Competition Commission (CC) in 2006, the CC concluded an in-depth investigation under the Enterprise Act 2002 into the supply of groceries in the UK. The report found a number of adverse effects on competition from grocery retailers as a result of high levels of concentration at a local level. In particular, the report concluded that the prevalence of restrictive covenants and exclusivity arrangements that seek to protect the seven largest UK supermarkets from local competition were particularly damaging. In order to address this issue, the CC introduced the Groceries Market Investigation (Controlled Land) Order 2010 (the Order).

In addition, the Land Agreements Exclusion Revocation Order 2010 was implemented so that land agreements no longer benefited from an exclusion from competition law.

Consequently, land agreements can now be assessed under the normal competition regime and anti-competitive agreements or clauses will be prohibited and unenforceable.

Timing

In July 2012, the OFT introduced a procedure for determining whether or not large grocery retailers can be required to give up the benefit of land use restrictions which limit competition.

Comments

Real estate transactions are increasingly being scrutinised by competition authorities. This illustrates the importance of taking a proactive approach to monitoring and assessing the implications of competition law on transaction planning. Potential consequences of being caught by these rules include increased costs, delays and even divestment.

Following the introduction of the Order, the OFT announced in June 2012 that businesses will be able to apply for the removal of land use restrictions which limit competition against any of the UK's seven largest grocery retailers (Asda, the Co-operative Group, Marks & Spencer, Morrisons, Sainsbury's, Tesco and Waitrose) (LGRs).

The Order lists a number of existing land use restrictions which prevent, restrict or distort competition, and the LGRs are required to use their best endeavours to release the restrictive covenant or exclusivity agreement in question. The Order also allows owners of burdened land to apply to the OFT to remove anti-competitive restrictions relating to grocery retail.

The procedure for this includes an assessment as to whether a local market is highly concentrated (by analysing the number of large or mid-sized stores owned or controlled by one of the LGRs and the share of the relevant market attributable to the LGRs within an identified isochrone).

The Order also obliges the LGRs to notify the OFT about certain proposed store acquisitions.

Solvency II and IORP update

John Forbes, member of the IPF Solvency II Working Group

Real estate industry interest in Solvency II and Occupational Retirement Provisions (IORP) has waned in recent months with the delays to the EU Parliament vote on the Omnibus II Directive to implement Solvency II. Like the French army at Agincourt, the Directive has become comprehensively bogged down. Progress through the mud has ground to a halt as arrows fly in from all directions. The similarity to the French knights ends there however – despite the barbs and the bogs, the European Insurance and Occupational Pensions Authority (EIOPA) retains its enthusiasm to press forward.

The latest EIOPA round of consultation on Solvency II closed on 19 June 2013. This was in respect of a 'Consultation on Guidelines on preparing for Solvency II' published on 27 March 2013 and consists of a series of guidelines for national regulators that include proposed interim measures in the following areas:

i. System of governance – CP 13/008

ii. Forward looking assessment of the insurer's own risks (based on ORSA principles) – CP 13/009

iii. Reporting to regulators – CP 13/010

iv. Pre-application for internal models – CP 13/011

These are intended to encourage national regulators to adopt consistent approaches in their preparations for implementation. EIOPA is expected to publish the results in the autumn. For the real estate industry, the most significant impact is likely to be in respect of the pre-application process for the approval of internal models and other quantitative aspects and that publication will prompt further Solvency II activity. The consultation assumes that full implementation of Solvency II will be delayed until 1 January 2016 but that Omnibus II will be voted through the EU Parliament in the autumn and that a phased introduction will then follow from 1 January 2014 to 1 January 2016. There is, however, a significant question mark over the timing of the Omnibus II vote. The major issue to be resolved is over the treatment of long-term guarantees. EIOPA has been working on this for several months and published its findings on 14 June. Whilst at one level publication moves things forward, the paper raises more questions and is more likely to delay the Omnibus II vote beyond October than to facilitate it.

The treatment of real estate under Solvency II

In terms of the treatment of real estate as an asset class, despite the best efforts of real estate organisations across Europe in lobbying against the 25% market shock for property, it is highly unlikely that further lobbying on this will yield any benefits. There are, however, other areas of concern for real estate that need to be a focus of attention and lobbying as interest in Solvency II and IORP rekindles in the autumn:

Most large insurers will be seeking approval for their own internally generated models. Although the EIOPA consultation in respect of internal models that recently closed was in respect of guidelines for local regulators rather than insurers, this will clearly, as intended, feed through to those who are being regulated. Further activity by insurers in respect of internal models can therefore be expected in the autumn, and the various real estate industry trade bodies need to be providing as much support as possible to insurers and regulators to ensure as favourable a treatment as possible for property in individual models.

Long-term investments

The treatment of long-term investments under Solvency II is under review. In September 2012, Jonathan Faull on behalf of the European Commission wrote an open letter to EIOPA in relation to insurers as long-term investors. The Commission was concerned to ensure that the market shock provisions under Solvency II do not discourage insurance companies from continuing to provide long-term finance to the European economy. Following this in December 2012, the IPF, INREV and a number of other industry bodies wrote to Director General Faull requesting that real estate should be included in the scope of the EIOPA review of long-term assets. His rather unhelpful response noted that EIOPA is free to recalibrate the solvency capital charge for real estate but declined to request EIOPA to include it in the exercise. The EC expanded on its earlier letter in March 2013 with a Green Paper on the 'Long-Term Financing of the European Economy' (COM(2013) 150/2). Consultations closed on 25 June 2013, with the IPF, INREV and others submitting responses.

Real estate lending

The treatment of real estate lending may be subject to change. The treatment that had been potentially very attractive under the original Solvency II provisions is now significantly less appealing and less logical. The draft implementing measures for Solvency II dated 31 October 2011, which have been widely circulated but never formally published, introduce a significant change to the proposed treatment of commercial real estate lending under the standard market shock formula. In earlier draft provisions, a specific treatment of property loans was included that took account of the value of collateral, using the property shock to adjust the value the collateral. This provision is now restricted to residential mortgages.

Under the 31 October draft, commercial real estate lending has been moved to the general provisions for corporate bonds. The starting point under this provision is a credit rating by a nominated credit rating agency. Bonds and loans for which a credit rating is not available are assigned a risk factor, in an example of presumably unintended humour, termed by the regulator 'F-up'. This does not reflect practice in property lending as individual commercial real estate mortgage loans are generally not rated. Furthermore, it is not clear how collateral should be taken into account. In the absence of any clear provision that would allow collateral to be taken into account, the assumption is that it should be ignored, which would seem to be an odd place for the regulation to end up. There had been a suggestion that this would be subject to further consultation after Omnibus II was passed but this was at a time when this was scheduled for July 2012. It is not clear whether this will still happen with the multiple delays to the EU Parliament vote.

Institutions for IORP Directive

The updating of the IORP Directive should, in theory, introduce Solvency II type provisions for occupational pension schemes. EIOPA is also the body responsible for the technical development of the IORP provisions so it should not have been a great surprise that the starting point for the quantitative impact assessment was the Solvency II equivalent, including the 25% market shock for property.

In a statement on 23 May 2013, Internal Market and Services Commissioner Michel Barnier indicated a change of direction. Whilst it remains his intention, "to come forward with a proposal for a Directive to improve the governance and transparency of occupational pension funds in the autumn of 2013. At this stage, and as long as more comprehensive data is needed and Solvency II is not in force, the proposal for a Directive will not cover the issue of the solvency of pension funds. In light of the differing situations in Member States regarding retirement products and pension funds, it is necessary to continue technical work on the issue of solvency". Many commentators have let out a huge sigh of relief and suggested that the solvency requirements have been postponed indefinitely, but it would be rash not to take Commissioner Barnier's comments at face value. His suggestion that more technical work is required and that this is dependent on the timing of Solvency II should be a clear message to the real estate industry to keep lobbying.

Conclusion

Although Solvency II and IORP may not have been grabbing the headlines over the next few months, things have been moving forward and important developments can be expected during the autumn and next spring. It is important that the real estate industry keeps abreast of developments and maintains its lobbying efforts. The IPF Solvency II Working Group will be sharing further updates in the autumn.

Improving energy efficiency in buildings – is Scotland ahead?

Alan Cook, Pinsent Masons LLP

To meet challenging targets to reduce carbon emissions, the UK and Scottish governments and the EU have introduced a plethora of legislation including the introduction of energy performance certificates (EPCs), more stringent building regulation standards for new buildings and legislation to ensure older building stock is brought up to modern building standards.

This article looks at forthcoming measures, both at a UK-level and those particular to Scotland.

Energy Act 2011

This Act has potentially UK-wide application. When implemented, it will prohibit landlords from letting properties that have a poor EPC rating (expected to be those below an 'E' rating). This must be brought into force in England & Wales by April 2018 at the latest. In Scotland, implementation of the measure is at the discretion of the Scottish government, which could choose for it to be introduced from as early as April 2015. However, if the Scotland-specific measures outlined below are felt to be working then the government may feel there is no need for a second layer of restrictions under the Energy Act.

Property industry working parties have been set up by the Department of Energy & Climate Change (DECC) to advise on possible regulations, one set for residential property and one for non-residential property. Formal consultation is expected later this year.

Climate Change (Scotland) Act 2009

This provides for improvements to the energy efficiency of non-domestic buildings in Scotland over 1,000 sq m that do not meet 2002 building standards.

The trigger for improvement works to take place will be when the owners wish to sell or lease the property (though not lease renewals) after forthcoming regulations come into force (expected to be early 2014). When either event occurs, the property owner will be required to provide the purchaser or tenant with an action on carbon and energy performance (ACEP), which will comprise an EPC and an 'action plan'.

The action plan will set out how the energy performance of the building can be improved and greenhouse gas emissions reduced. The purchaser/landlord will then have the option of either carrying out the works specified in the action plan within a set period of time (3.5 years has been suggested) or recording the energy usage of the property over a period of time, with a view to reducing the energy consumption. It is anticipated that, over time, energy efficiency improvements will become increasingly mandatory as this regime is strengthened.

Energy efficiency measures are also to be introduced for domestic property although this is still at the working group stage.

Common features

There are a number of common features to the measures in Scotland and the rest of the UK, including:

- Green Deal exemption – Both sets of implementing regulations are expected to exempt premises in respect of which there is a Green Deal plan. The Green Deal will enable homeowners and businesses to have energy efficiency improvements to their property carried out with the cost of the work (plus interest) being recovered over time (up to 25 years), via instalment payments added to the energy bills for the property.
- Issues for the landlord-tenant relationship – The onus is on landlords to ensure compliance. Whether and how landlords pass on the costs of compliance to tenants remains to be seen and will also depend on individual lease terms.
- Impact on property values – Energy efficiency does not contribute currently to an increase in property valuations; however we can anticipate an increasingly two-tier property market where the value of properties that do not meet the relevant standards will be marked down to reflect the anticipated cost of requisite improvements.
- Tightening regimes – Both sets of measures are to be fleshed out by regulations, giving scope for tightening of the regimes over time without the need for further primary legislation.

Distinguishing features

Differences between the two regimes include:

- The Climate Change (Scotland) Act measures will take effect some years before the Energy Act measures commence in England & Wales.
- In Scotland, the Climate Change (Scotland) Act measures will affect both sales and lettings; in England & Wales, only lettings will be restricted.
- While EPCs play a key role in both regimes, in Scotland the basis for assessment of EPC ratings is different from that in England & Wales, which can lead to different ratings for otherwise identical buildings. It is anticipated that this will be regularised in time.

It is clear that energy efficiency of buildings is set to be an increasingly significant issue for property owners both north and south of the border. Only time will tell how great the impact on the property market will be. In the meantime, active engagement by all members of the property industry in the detail and implementation of the measures is essential.

IPF Investment Property Forum

The Great Debate and Dinner

“Would independence be good for the Scottish property market?”

Thursday 12 September 2013
Commencing at 5pm | Dress: Business suit

Hilton Glasgow Hotel
1 William Street, Glasgow G3 8HT

The IPF invites you to a debate on the impact that independence could have on the real estate investment market in Scotland.

Following an overview of the constitutional and economic position, two leaders in the real estate investment market in Scotland will make the case for and against independence. Everyone will then be invited to join the debate.

For more information or to book, please contact Barbara Hobbs on 020 7194 7924 or email bhobbs@ipf.org.uk

Comparison of SDLT and LBTT

Iain Doran,
Dundas &
Wilson CS LLP

The Land and Buildings Transaction Tax (LBTT) Bill, which introduces LBTT in Scotland in place of SDLT, has now passed through all its stages in the Scottish Parliament, and is expected to receive Royal Assent (and thus become law) shortly. There are however a lot of details not yet finalised (e.g. re: leases) which will depend on secondary legislation.

LBTT will apply to transactions involving Scottish property from 1 April 2015.

The key differences between SDLT and LBTT

SDLT	LBTT
Method of charge SDLT is charged on the whole price if it exceeds the nil rate threshold at one single rate – known as a 'slab' tax.	**Method of charge** LBTT will be charged at various rates between certain thresholds and the results added together (like income tax) – known as a progressive tax.
Nil rate threshold Nil rate up to £150,000 (commercial property) or £125,000 (residential).	**Nil rate threshold** The threshold has not yet been confirmed, but the illustrative figures published by the Scottish Government use £125,000 and £180,000 in two scenarios for residential property, and £150,000 for commercial property.
SDLT rates for purchase (commercial) 1% for prices between £150,001 and £250,000 3% for prices between £250,001 and £500,000 4% for prices over £500,000.	**LBTT rates for purchase (commercial)** Details have not yet been published for the rates or thresholds for commercial or residential. However, previous announcements have indicated an initial intention to structure the tax so that it raises the same total amount as SDLT in Scotland, but with purchases up to £2m incurring less tax, and purchases over £2m incurring more.
SDLT rates for purchase (residential) 1% for prices between £125,001 and £250,000 3% for prices between £250,001 and £500,000 4% for prices between £500,001 and £1m 5% for prices between £1m and £2m 7% for prices over £2m 15% for prices over £2m if purchaser is not a natural person, e.g. is a company.	**LBTT rates for purchase (residential)** See comments on commercial purchase. The break-even point may be around £300,000, so that the 7% of purchases above that price incur more tax than under SDLT. The Scottish Government intends to charge LBTT on the purchase of shares in companies that hold residential property, and this may be a way to charge a 15% rate or similar on high value property, as operates for SDLT.
SDLT rates for rent under a lease 1% of the net present value (NPV) of the total rental payments (including VAT) to be made over the duration of the lease, less £150,000 (or £125,000 for a residential lease). The formula for calculation of the NPV uses a temporal discount rate of 3.5%. NPV is calculated on the basis that the rent for any years after the end of year five is at the highest rate payable over and 12-month period within the first five years, even if the lease already fixes rent for any year from six onwards at a higher rate. There are various technical difficulties with uncertain rents (e.g. turnover rents) under SDLT, with multiple returns being required as rents are finalised. All licences are exempt from SDLT.	**LBTT rates for rent under a lease (or licence)** Residential leases (which are less common in Scotland as they cannot exceed 20 years) are to be exempt from LBTT. The LBTT Bill contains merely an enabling measure about commercial leases, so that secondary legislation can be introduced in due course. The stated intention however is to retain the NPV approach, but with the calculation being revisited at set intervals of three years to cater for uncertain rents (e.g. turnover rents). Licences generally are to be exempt from LBTT, but some (which closely resemble leases, e.g. shops in airports) will be subject to LBTT.

The key differences between SDLT and LBTT (cont'd)	
SDLT reliefs There are many reliefs from SDLT, though several operate only in very limited circumstances.	**LBTT reliefs** Most of the SDLT reliefs are to be replicated in LBTT, but a notable exception is sub-sale relief, which is not generally to be available. However, it is anticipated that guidance or regulations will be published before commencement which will preserve relief for forward funding transactions, and for the common situation of a purchaser under an uncompleted contract nominating a third party (e.g. a newly-formed SPV) to take title at completion.
Collector SDLT is collected by HMRC.	**Collector** LBTT is to be collected by a new body to be known as 'Revenue Scotland', working in conjunction with the Scottish Land Register – to link the processes of payment of LBTT and registration of title.
Timing for payment SDLT is payable within 30 days of the effective date (which is usually, but not always, the completion date). SDLT is usually paid at the same time as submission of the tax return.	**Timing for payment** LBTT will be payable at the same time as submission of the tax return – which must be done within 30 days of the effective date.

An answer to the flood insurance problem?

Bill Gloyn, Partner, European Real Estate, JLT Specialty Limited

So, at last there has been some news about the future of flood insurance! I had really hoped that there would be a happy ending to this issue before I reach the 50 years in real estate insurance that marks my retirement in August. Sadly, that is not yet the case.

Of course, the government spin would have you believe that it is all sweetness and light but, following my previous comments on the topic in the July 2011 edition of Focus, let's look at the facts.

To go back to the beginning, there was a deal in 2008 – the Statement of Principles (SoP) – between the Association of British Insurers (ABI) and the government that flood insurance would remain available for high risk properties. This ran out on 30 June 2013 but was extended for a month in May to give extra time to reach agreement. As the deal originally had a five-year life, it has gone up to the wire to get this far.

The option on the table, now subject to formal consultation that ends on 8 August, is for the ABI to establish Flood Re – a pool that would insure high-risk properties that the insurers cannot accept. The consultation can be found at: www.gov.uk/government/consultations/insurance-in-areas-of-flood-risk

Why is a formal consultation necessary? Basically because the ABI option is still not the accepted solution – despite what has been said in the recent news announcements. The government wants legislation, to be attached to the Water Bill currently before parliament, to give it the flexibility to go down a different route if the ABI scheme cannot be tailored to suit its demands. To quote from the consultation document:

"The government's preference is to work with the insurance industry to secure the affordability and availability of flood insurance. Government will also seek powers in reserve to regulate for affordable cover. Having a fall-back means customers can have confidence in this issue being addressed one way or another."

The phrase, "seek powers in reserve to regulate for affordable cover", has an ominous tone. It hints at forcing insurers to issue insurance on government prescribed terms.

In fact, the plan is to have a 'Flood Insurance Obligation' by which all insurers writing household insurance in the UK would be required to insure a certain proportion of high risk properties – or face enforcement action. This would work on the basis of insurers having to offer sufficiently attractive terms to win enough business to fulfil their obligations under the targets set by government. Just contemplate that and it soon becomes apparent just how unworkable and bureaucratic such a scheme would be – with a register of 'at risk' properties and a Regulator and support staff to make it work. Such are the ways of civil servant thinking!

It is hoped that the not-for-profit scheme can be set up by the summer of 2015, until when ABI members have voluntarily agreed to extend the SoP arrangements for existing customers.

The income to support the scheme will come from a levy of £10.50 on all home insurance policies. This, it is suggested, is the equivalent of the cross-subsidy that exists between low and high-risk policies at present – where there is generally no difference in premium between those categories.

In addition, an additional risk based premium will be charged to all those policy holders determined by the insurers to be in a high-risk area. This will be subject to a cap that will be based on council tax bands, starting at no more than £210 per annum in bands A and B, rising to £540 per annum in band G (or equivalent outside England).

It is important to note that the proposed new scheme will only apply to residential properties, not even to SMEs as before. In fact, it is specifically highlighted that even a home used for B&B purposes is not automatically covered but will be subject to further consideration. Properties built after 1 January 2009 continue to fall outside the scheme but a new exclusion is for residential properties in tax band H. That might affect a number of MPs so watch this space!

I have previously identified the problems that will evolve from the failure to insure flood – breach of loan and lease terms; difficulties with funding or letting; subsequent collapse of the property market in affected areas; non-repair of damage and subsequent urban and social decay. Even if the proposed scheme does get off the ground it does not address the issue of flood insurance for commercial property owners or occupiers.

It remains to be seen what will happen with the residential proposal after the consultation. Whatever the outcome, it will certainly influence the underwriting attitude for commercial property. The RICS has addressed this in the guidelines for valuers in flood risk areas. The impact on investment values will be felt sooner rather than later.

So you can see why it is important to understand what is proposed and respond to the consultation if you consider that it will prejudice your interests. No one else will be looking after them for you!

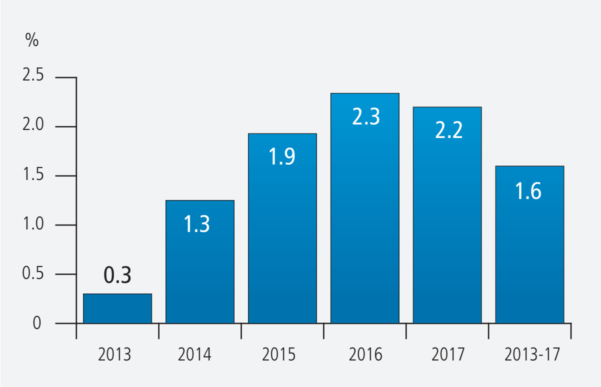
UK Consensus Forecasts
May 2013

All Property average annual rental value growth forecasts

Maintaining the sentiment of last quarter's reported figures, rental growth expectations remain weakly positive in 2013.

With the exception of the current year, however, projected growth rates throughout the five-year period of the survey are marginally lower than those forecast in February. Rental value growth is expected to peak in 2016 but falls short of the long-run average rate of over 3.0% per annum.

Figure 1: All Property rental value growth forecasts

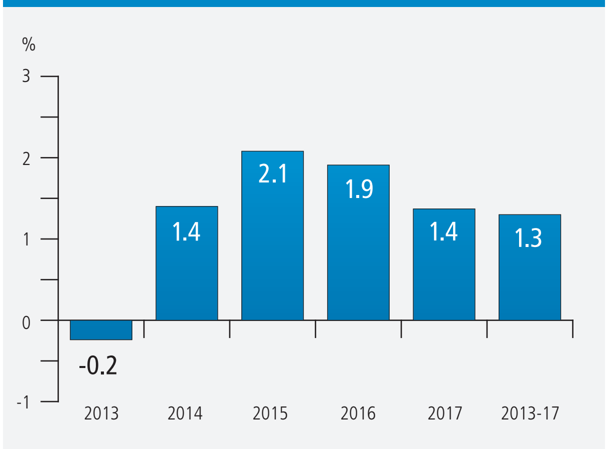


All Property average annual capital value growth forecasts

On average, forecasters still expect negative capital value growth in 2013, although there has been a substantial improvement, of more than 0.5%, over the February prediction.

The general pattern of growth peaking in 2015 is consistent with previous surveys. Whilst the differences in predictions over the quarter are relatively modest, in combination the resultant five-year average has improved slightly, to 1.3% from 1.2%, although still only around a half of the long-run average rate of 2.5% per annum.

Figure 2: All Property capital value growth forecasts

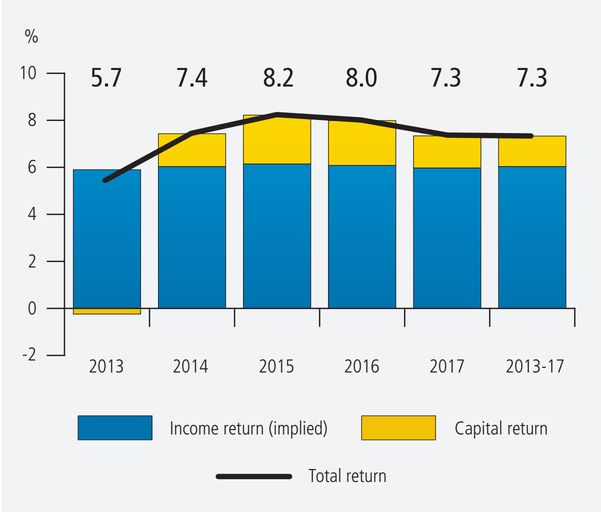


All Property average total return forecasts

The All Property total return measure for 2013 continues to be adversely affected by negative capital value growth. The projection of a little less than 5.7% for the year implies an income return of around 5.9%.

Positive capital growth from 2014 onwards should help to deliver an expected five-year average of around 7.3%, although the majority of this performance is still derived from the income component (at around 6.0%).

Figure 3: All Property total return forecasts



Notes

1. Figures are subject to rounding and are forecasts of All Property or relevant segment Annual Index measures published by the IPD. These measures relate to standing investments only, meaning that the effects of transaction activity, developments and certain active management initiatives are specifically excluded. **2.** To qualify, all forecasts were produced no more than 12 weeks prior to the survey. **3.** Maximum: The strongest growth or return forecast in the survey under each heading. **4.** Minimum: The weakest growth or return forecast in the survey under each heading. **5.** Range: The difference between the maximum and minimum figures in the survey. **6.** Median: The middle forecast when all observations are ranked in order. The average of the middle two forecasts is taken where there is an even number of observations. **7.** Mean: The arithmetic mean of all forecasts in the survey under each heading. All views carry equal weight. **8.** Standard deviation: A statistical measure of the spread of forecasts around the mean, calculated at the 'All forecaster' level only. **9.** There was one 'other' (non-equity broker) contributor this quarter, whose data is incorporated at the 'All forecaster' level only. **10.** In the charts and tables, 'All Property' figures are for all 30 contributors.

Acknowledgements

The Investment Property Forum would like to thank all those organisations who contributed to the IPF UK Consensus Forecasts for Q2 2013, including the following: **Property advisors (including research consultancies):** BNP Paribas Real Estate, Capital Economics, CBRE, Cluttons, Colliers International, Cushman & Wakefield, Deloitte Real Estate, Fletcher King, GVA, Jones Lang LaSalle, Knight Frank, Paul Mitchell Real Estate Consultancy Limited, Real Estate Forecasting Limited, Strutt & Parker. **Fund managers:** Aberdeen Asset Management, Aviva Investors, AXA Real Estate, CBRE Global Investors, Cordea Savills, Cornerstone Real Estate Advisors, F&C REIT Asset Management, Henderson Global Investors, HSBC Global Asset Management, Ignis Asset Management, Keills, LaSalle Investment Management, PRUPIM, SWIP, Standard Life Investments.

All Property survey results by contributor type

(Forecasts in brackets are February 2013 comparisons)

Figure 4: Property advisors and research consultancies (14 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2013		2014		2013-17		2013		2014		2013-17		2013		2014		2013-17	
Maximum	0.8	(1.3)	2.5	(2.8)	3.2	(3.2)	1.4	(1.4)	4.7	(3.5)	3.6	(3.6)	7.3	(7.4)	10.0	(9.9)	8.8	(8.8)
Minimum	-0.9	(-0.9)	0.6	(-0.4)	1.1	(0.8)	-1.8	(-1.5)	-0.2	(0.0)	0.2	(0.5)	3.5	(3.6)	5.8	(5.9)	6.2	(7.0)
Range	1.6	(2.3)	1.9	(3.1)	2.1	(3.1)	3.2	(2.9)	4.9	(3.6)	3.4	(3.1)	3.8	(3.8)	4.2	(4.0)	2.6	(1.8)
Median	0.2	(0.5)	1.5	(1.6)	1.8	(2.0)	-0.1	(-0.5)	1.5	(1.3)	1.7	(1.7)	5.8	(5.6)	7.7	(7.5)	7.6	(7.7)
Mean	**0.3**	**(0.3)**	**1.4**	**(1.5)**	**1.9**	**(2.1)**	**-0.2**	**(-0.3)**	**1.7**	**(1.5)**	**1.6**	**(1.6)**	**5.6**	**(5.7)**	**7.6**	**(7.6)**	**7.7**	**(7.8)**

Figure 5: Fund managers (15 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2013		2014		2013-17		2013		2014		2013-17		2013		2014		2013-17	
Maximum	1.1	(1.2)	2.4	(2.9)	2.6	(2.7)	2.1	(1.5)	4.2	(3.5)	3.4	(2.5)	8.1	(7.6)	10.1	(9.8)	9.1	(8.5)
Minimum	-0.5	(-1.8)	-0.2	(-1.4)	-0.5	(-0.1)	-3.0	(-4.1)	-1.9	(-1.0)	-0.8	(-1.1)	3.2	(2.0)	4.1	(5.2)	5.2	(5.1)
Range	1.6	(3.0)	2.6	(4.3)	3.1	(2.8)	5.1	(5.6)	6.1	(4.5)	4.2	(3.6)	4.9	(5.6)	6.0	(4.6)	3.9	(3.4)
Median	0.6	(0.1)	1.2	(1.0)	1.4	(1.3)	0.0	(-1.3)	1.1	(1.1)	1.2	(1.0)	5.8	(4.7)	7.2	(7.3)	7.1	(7.0)
Mean	**0.3**	**(0.1)**	**1.1**	**(1.3)**	**1.3**	**(1.3)**	**-0.3**	**(-1.3)**	**1.2**	**(1.0)**	**1.0**	**(1.0)**	**5.7**	**(4.7)**	**7.4**	**(7.2)**	**7.1**	**(7.1)**

Figure 6: All forecasters (30 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2013		2014		2013-17		2013		2014		2013-17		2013		2014		2013-17	
Maximum	1.1	(1.3)	2.5	(2.9)	3.2	(3.9)	2.1	(1.5)	4.7	(3.5)	3.6	(3.6)	8.1	(7.6)	10.1	(9.9)	9.1	8.8
Minimum	-0.9	(-1.8)	-0.2	(-1.4)	-0.5	(-0.1)	-3.0	(-4.1)	-1.9	(-1.0)	-0.8	(-1.1)	3.2	(2.0)	4.1	(5.2)	5.2	5.1
Range	2.0	(3.1)	2.7	(4.3)	3.7	(4.0)	5.1	(5.6)	6.6	(4.5)	4.4	(4.7)	4.9	(5.6)	6.0	(4.7)	3.9	3.7
Std. Dev.	0.5	(0.7)	0.6	(0.7)	0.8	(0.7)	1.2	(1.1)	1.4	(1.2)	1.2	(0.8)	1.2	(1.2)	1.3	(1.3)	1.0	0.7
Median	0.3	(0.3)	1.4	(1.4)	1.6	(1.7)	0.0	(-0.8)	1.4	(1.3)	1.3	(1.2)	5.9	(5.2)	7.4	(7.4)	7.4	7.5
Mean	**0.3**	**(0.2)**	**1.2**	**(1.3)**	**1.6**	**(1.7)**	**-0.2**	**(-0.8)**	**1.4**	**(1.2)**	**1.3**	**(1.2)**	**5.7**	**(5.2)**	**7.4**	**(7.4)**	**7.3**	**7.4**

Note
Consensus forecasts further the objective of the IPF to enhance the efficiency of the real estate investment market. The IPF is extremely grateful for the continuing support of the contributors as noted above. This publication is only possible thanks to the provision of these individual forecasts..

If your organisation wishes to contribute to future surveys, please contact the IPF Research Director at pcraddock@ipf.org.uk.

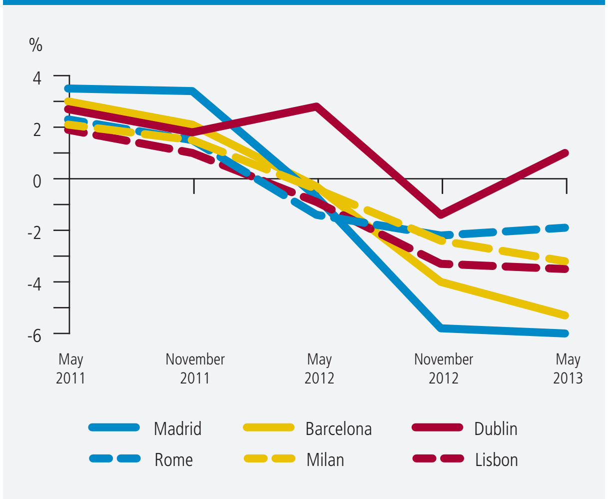
European Consensus of Prime Office Rental Forecasts
May 2013

2013 expectations weaken

Since the last survey, growth projections for the current year have generally softened, with 10 centre forecasts being more than 1% lower than six months ago, compared to only six weakened forecasts of this magnitude in November. Prospects for seven markets have improved by more than 1.0% in the six-month period but this compares to 12 previously. All German locations are expected to see rental growth of between 1.2% and 2.1%, as vacancy rates decline. Likewise, supply constraints in central London will underpin the continued growth expectations in these markets.

At a sub-group level, Figure 1 illustrates a levelling off in declining growth trajectories for the majority of the peripheral eurozone economies, with the exception of Dublin, the only location expected to return to positive growth this year. This may be explained by the low rate of corporation tax attracting overseas entities, with these companies having been a major driver of take-up over the last 12 months. Despite a high take-up in the Madrid market in the first quarter of 2013, primarily due to three large transactions which make up almost half of the total, forecasts remain depressed for this centre in the immediate future.

Figure 1: Weighted rental growth forecasts 2013 – peripheral economies



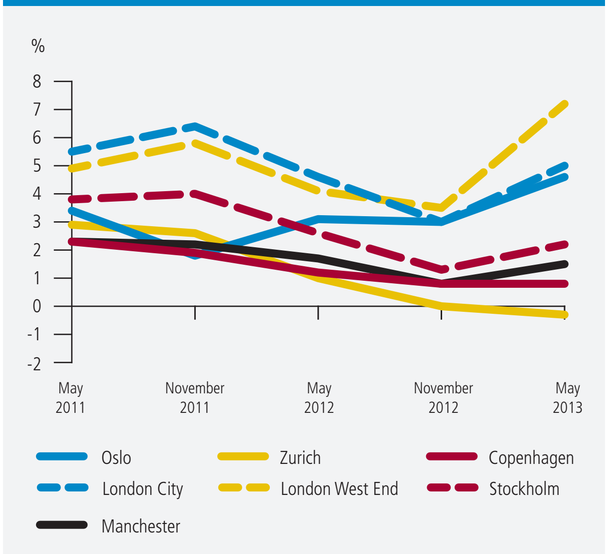
Of the six other office markets that are expected to deliver negative growth in 2013, the prediction for Paris la Défense has weakened further, to -2.3% from -0.3%, and the Paris CBD is also expected to be weakly negative at -0.2%, driven by rising vacancy rates as new developments come on stream. Forecasts of other centres that have fallen below zero growth include Warsaw (-1.1%), which will see its highest number of completions in over a decade due to a large number of projects in the pipeline, and Amsterdam (-0.8%)

In terms of the range of average growth rates between centres, the spread has fallen back slightly in the last six months, to 13.2% (from 14.6% in November), although this continues to evidence diverging economic prospects across the continent. Forecast projections for individual centres continue to show remarkable variation in the short-term. Six sets of forecasts for the current year capture ranges in excess of 10.0% (12.9% in the case of the Madrid market).

Outside the eurozone

Contrary to the November 2012 forecasts, Figure 2 illustrates that prospects for growth outside the eurozone have improved for all locations other than Copenhagen and Zurich. The latter is expected to decline despite the relative health of the Swiss economy, primarily due to high construction activity. The Oslo market continues to be underpinned by limited development activity and a robust economy, supported by substantial oil revenues.

Figure 2: Weighted average rental growth forecasts 2013 – non-euro centres



Three- and five-year averages improve

Longer-term forecasts indicate strengthening prospects for growth. Eight of the three-year average forecasts have improved by more than 1.0% over the last six months, whilst only four have worsened by more than -1.0% (as compared to eight in November). Over the period 2013-17, the weakest average growth forecasts continue to be generated by southern peripheral eurozone centres, ranging from -1.4% for Barcelona to -0.8% for Rome. Only six locations are forecast to deliver negative growth (compared to 10 in November 2012) with a further six markets offering weakly positive growth (less than 1.0%). Leading markets over the same period continue to be London (West End and City) and Oslo, ranging from 5.5% to 4.0%. There were insufficient data returns for Moscow to permit analysis on this occasion.

The five-year outlook continues to improve as all locations measured are forecast to deliver positive average annual rental growth, albeit five centres are projected to deliver sub -1.0% growth. The outlook to 2017 suggests average annual rental growth may improve by more than 1.0% in 15 markets, as compared to only two at November 2013.

As highlighted in the previous survey report, the three- and five-year averages for Dublin continue to show a significant improvement: the three-year annual average growth rate is now 3.3%, rising to 5.4% per annum over five years.

Ten forecasts indicate growth of 2.0% or more per annum over the period 2013-17. After Dublin, Madrid shows the biggest gain over the last six months, averaging 2.8% per annum, compared to 0.4% per annum in November, driven by increased growth later in the forecast period.

Conclusions

Peripheral eurozone economies broadly remain the weakest markets, although Dublin is the one outstanding exception. The Irish capital, together with a majority of the other office centres outside the eurozone, offers the best prospects of growth over various time periods.

Rolling three- and five-year annualised growth rates suggest that most markets are stabilising. In the immediate future, i.e. 2013, however, rental growth rates are predicted to weaken across many centres.

Acknowledgements

Forecast Contributors

IPF would like to thank all participants in the survey for contributing rental data to the May 2013 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, AEW Europe, Aviva Investors, AXA Real Estate, CBRE, CBRE Global Investors, Danish Property Federation, Deutsche Asset & Wealth Management, DTZ, Grosvenor, Henderson Global Investors, Invesco, Jones Lang LaSalle, Paul Mitchell Real Estate Consultancy Limited, PPR and Standard Life Investments.

Notes

At present the IPF European Consensus Forecasts survey focuses on office rental value growth in major cities. It is not possible currently to assemble sufficient forecasts of all sectors across all European countries to produce a meaningful consensus of views, although our ambition is to extend and improve the scope of the survey.

In addition to the rental value forecasts, we run a consensus survey of forecast IPD European total returns by sector. The samples provided for this survey were once again insufficient to permit publication, as fewer than five forecasts were received for each sector/territory. We aim to produce a full release of this data at a future date, once the number of responses has grown sufficiently.

The Data

This latest survey collected prime office rental forecasts for 30 centres for the calendar years 2013, 2014 and 2015. We request a three-year average forecast for 2013-2015 where individual years are not available as well as a five-year average for 2013-2017. The survey requested both the percentage annual rental growth rates and also the year-end rent levels. The growth forecasts provided by each organisation are analysed to provide weighted average ('consensus') figures for each market. Figures are only aggregated and reported for office markets for which a minimum of five contributions are received, hence data is reported for only 28 centres (Athens and Moscow have been omitted for this reason).

The definition of market rent used in the survey is "achievable prime rental values for city centre offices, based on buildings of representative size with representative lease terms for modern structures in the best location." Prime in this case does not mean headline rents taken from individual buildings but, rather, rental levels based on market evidence, which can be replicated. All figures included in the survey are required to have been generated by formal forecasting models. This report is based on contributions from 15 different organisations (fund management houses and property advisors).

Consensus forecasts further the objective of the Investment Property Forum to enhance the understanding and efficiency of the property market. The IPF is extremely grateful for the support those organisations that contribute to this publication, which is only possible thanks to the provision of individual forecasts.

The IPF welcomes new contributors for future surveys, so that the coverage of the market can be widened. If your organisation wishes to contribute to future surveys please contact Pam Craddock, IPF Research Director at pcraddock@ipf.org.uk.

Contributors receive a more detailed set of statistical outputs than those shown in the table above for each office centre the sample size, median and range of rental values are also provided.

Forum activities and announcements

IPF Chairman

At the Annual General Meeting, **Andrew Smith** of Aberdeen Asset Management succeeded Amanda Howard as Chairman of the IPF. **Max Sinclair** of Hypothekenbank Frankfurt AG has become Andrew's Vice Chairman.

Governance

The new IPF structure was officially passed at the AGM in June. The Management Board and the Executive Committee have been replaced by the Strategic Advisory Group and the director-level Operational Board.

IPF Executive

We are delighted to welcome **Lois Fidler**, who has joined the Executive team as Educational Events Manager. She is your first point of contact for all seminars and workshops, both in the regions and London. Lois can be reached at lfidler@ipf.org.uk or on 020 7194 7926.

25th Anniversary Annual Dinner

Andrew Smith, Sue Forster, Max Sinclair

The 25th Anniversary Annual Dinner took place on Wednesday 26 June 2013 at the Grosvenor House, London. Over 900 guests were entertained by magicians, a jazz trio and the after-Dinner speaker, comedian Fred MacAulay.

Fred MacAulay

IPF Midlands Lunch

Dennis Turner, Amanda Howard, Tim Hurdiss

The IPF Midlands Lunch took place on 10 May 2013 at the ICC in Birmingham. Dennis Turner, former Chief Economist at HSBC gave guests his take on prospects for the UK economy over the next 12-24 months.

Dennis Turner

Next Generation Drinks Reception

At July's Next Generation Drinks Reception attended by members and invited non-members, **Neil Turner** of Schroders gave his personal perspective on prospects for the fund mangement industry. Any non-members interested in joining the IPF Next Generation should contact Cheryl Collins ccollins@ipf.org.uk

IPF 25th Anniversary

2013-14 marks the 25th Anniversary year of the IPF. The Operational Board and the 25th Anniversary Committee are organising a number of events and initiatives to mark the occasion. We will be holding a members' party at the London Transport Museum on the evening on 27 November. Further information will be sent to all members shortly. We very much hope that you will be able to join us.

LinkedIn

The IPF has created a number of LinkedIn groups. If you would like to join, just search on 'Investment Property Forum Members'.

Investment Education Programme

The Investment Education Programme 2013-14 cycle will be commencing with Investment Valuation and Portfolio Theory on 7-9 October.

The Programme consists of seven modules, the successful completion of which leads to the IPF Diploma. Further details are available on the IPF website and on the University of Cambridge ICE website, www.ice.cam.ac.uk/investment – or if you would like to discuss education opportunities in person, please contact Frankie Trailor, or the Programme Office (01223 760860). Dates for the next cycle are as follows:

- Investment Valuation and Portfolio Theory
7-9 October 2013
- Financial Instruments and Investment Markets
18-20 November 2013
- Property Investment Appraisal
27-29 January 2014
- Property Finance and Funding
24-26 March 2014
- International Property Investment
12-14 May 2014
- Indirect Property Investment
23-25 June 2014
- Portfolio Management
30 September – 2 October 2014

IPF Postgraduate Dissertation Prize

To mark its 25th Anniversary, IPF is establishing a Postgraduate Dissertation Prize. This is intended to be awarded annually to the student who produces the best investment-related dissertation, worthy of a 'merit' or above, on each of the postgraduate courses recognised by the IPF. The IPF Educational Strategy Group (ESG) will be responsible for overseeing the awards.

The annual Prize of £500 per course is intended to provide further support for educational courses about property investment and/or finance and to help foster closer links with academic institutions. The prize would also be open to PhD candidates who are at the institutions running the recognised courses, which are as follows:

- University of Aberdeen – MSc Real Estate Finance
- University of Cambridge – MPhil in Real Estate Finance
- Cass University Business School – MSc in Real Estate Investment
- College of Estate Management (CEM) – MSc/RICS Diploma in Property Investment
- London School of Economics – MSc Real Estate Economics and Finance
- Nottingham Trent University – MSc Real Estate Funding and Finance
- University of Reading – MSc Real Estate Investment; and MSc Real Estate Finance

Currently, the ESG is scrutinising another MSc course to decide whether to grant it IPF 'recognised' status.

For further information about the Prize, please contact Sue Forster: sforster@ipf.org.uk

IPF Mentors

Following feedback from the recent membership survey, the IPF has decided to reinstate its 'mentor' scheme. The scheme identifies senior people within their respective areas of expertise who are willing to provide mentoring on an informal basis to those members who have lost their jobs or are at risk of doing so.

It is hoped that the scheme will be up and running again in September. If you are interested in being a mentor, please email Sue Forster (sforster@ipf.org.uk) with your contact details and an overview of which industry segment/s and geographical area/s you cover.

Constructing an Effective Rental Value Index

As reported in the April 2013 edition of Focus, IPF Consultant **Paul McNamara** has been co-ordinating the industry consultation on the proposals put forward by **Neil Crosby** and **Steven Devaney** in the **IPF Research Short Paper 18, Constructing an Effective Rental Value Index**. The responses to the six-week consultation are summarised below.

Type of organisation	No.
Industry organisation (RICS)	1
Investors	7
Valuers	8
Valuation data 'infrastructure' providers	3
Researcher	1
Accountants	1
Investment agent	1
Independent	1
Total	**23**

Following consideration of the written submissions, four meetings were arranged to discuss key issues.

Meetings arranged	Date
Meeting between IPF Research Team and IPD, to discuss practical issues of implementation	14 May
Meeting between IPF Research Team, IPD, ARGUS, KEL, OSCRE and YARDI to discuss practical issues of implementation	28 May
2 round-table meetings with mixed groups of investor and valuer representatives to discuss outstanding theoretical and practical issues from the Short Paper 18 consultation	11 June & 14 June

Substantial progress has been made and a further update will be forthcoming in the autumn. The IPF would like to thank all participants for their contributions to this consultation.

INREV | IPF Investment Property Forum | SPR

About the Nick Tyrrell Research Prize

The Nick Tyrrell Research Prize has been established by INREV, the Investment Property Forum (IPF) and the Society of Property Researchers (SPR) to recognise innovative and high-quality, applied research in real estate investment.

The Prize is in memory of the work and industry contribution of Nick Tyrrell, who sadly passed away in August 2010. Nick was Head of Research and Strategy and a Managing Director in J.P. Morgan Asset Management's European real estate division. His research work was characterised by a combination of academic rigour and practical relevance.

1. The Prize

- The Prize includes the following elements:
  - an award of £2,000;
  - a certificate presentation (which may be held at one of the conferences / dinners organised by one of the sponsoring organisations);
  - the opportunity to present the paper at a seminar organised by the sponsoring organisations; and
  - the inclusion of the article (or a summary thereof) in one or more of the sponsoring organisations' publications;

All of the above elements may be changed at the discretion of the three sponsoring organisations and the IPF Educational Trust.

2. Prize criteria

- Papers should represent, in the opinion of the Judges (listed below), high-quality research that is:
  - innovative, original and timely;
  - relevant to the real estate investment industry (listed/unlisted, direct/indirect, equity/debt);
  - of publishable quality in a leading academic real estate journal (e.g., the Journal of Property Research); and
  - typically between 5,000 and 10,000 words.
- Both single author and joint author submissions are permitted.
- Preference will be given to those papers where one or more of the authors is associated with a real estate investment management organisation or similar, by way of a full-time or part-time position.

3. Submission of papers

- Papers should be submitted directly by email to the Secretary, as nominated by INREV, the IPF and the SPR, stating any involvement or sponsorship by third parties.
- The deadline for submission of papers is 31 May each year.
- Papers that have been submitted for other prizes may only be considered with the explicit consent of one of the Judges.
- Sponsored pieces may be submitted with the written consent of the sponsor. A copy of this consent should be included with the submission.
- Only completed research papers will be considered by the panel of judges. Proposals for papers may be discussed with the Secretary.
- Ideally, the Prize will be awarded to an unpublished paper, but papers may be considered that:
  - have been published in the academic or professional press no longer than one year before submission;
  - presented to a conference no longer than one year before submission; or
  - are being considered for publication at the time of submission.
- The Secretary will distribute the papers to the Judges. The Judges will not correspond on any submissions directly.
- The Judges are under no obligation to award the Prize.

4. Management of the Prize

- INREV, the IPF and the SPR will be responsible collectively for the administration of the Prize and will appoint a Secretary to liaise with the Judges and the IPF Educational Trust.
- The Prize will be funded by monies from the Nick Tyrrell Memorial Fund, which is administered by the IPF Educational Trust, an independent charitable body.
- Monies for the Prize will be raised by the three sponsoring organisations on an as-and-when basis. The three organisations will each be responsible for publicising the Prize and for all aspects of management.
- The three sponsoring organisations will each appoint one Judge to sit on the judging panel. An additional (fourth) Judge will be appointed collectively. All judges will serve a two-year term and may serve a maximum of two consecutive terms. The fourth Judge will act as Chairman.
- The judging panel should comprise individuals with broad and substantial experience from both academia and practice. At least one member of the judging panel will have experience of non-UK real estate markets.

5. Fund raising

- Funds will be raised for the Prize from the following sources:
  - members of the sponsoring organisations;
  - special events, such as the Nick Tyrrell Memorial Seminar (the first Memorial Seminar took place on 12 October 2011); and
  - corporate donations.

6. Other issues

- Should the Fund be unable to award the Prize due to insufficient funds and the three sponsoring organisations choose not to seek additional funds, the remaining monies in the Memorial Fund would be merged with those of the IPF Educational Trust, to be used at the discretion of the Trustees.
- Similarly, should all three sponsoring organisations choose to cease awarding the Prize, the remaining monies in the Memorial Fund would be merged with those of the IPF Educational Trust, to be used at the discretion of the Trustees.
- Should the Prize not to be awarded at any time during a four-year period, for whatever reason, the Prize would terminate automatically unless the three sponsoring organisations all agree otherwise.

Judges (2012/13)

Dr Robin Goodchild (chair)
Professor Colin Lizieri
Dr Brenna O'Roarty
Dr Neil Turner

Secretaries (2012/13)

Dr Paul Kennedy email: paul@pjkennedy.co.uk
Anne Koeman email: anne.koeman@gmail.com

IPF Investment Property Forum

25 YEARS

Join us to celebrate our 25th Anniversary

Midlands Dinner 2013

Thursday, 10 October 2013

ICC, Broad Street
Birmingham

18:30 Pre-dinner drinks
19:30 Dinner

Black Tie

After Dinner Speaker:
Jeremy Vine
Broadcaster

Ticket price: £92.50 + VAT

£111 inclusive of VAT @ 20% per person

The ticket price excludes wine and other beverages.

For more information or to book, please contact Barbara Hobbs on 020 7194 7924 or email bhobbs@ipf.org.uk

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