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11 May 2011

Dear Syed,

EMIR and the real estate industry

ZIA and BPF welcome the efforts of the European institutions to improve transparency and stability on the OTC derivatives market. However, we are deeply concerned that the draft regulation, currently under discussion in the European Parliament and the European Council, could lead to an unjustified disadvantage for the real estate sector and an increase (rather than a decrease) in potential market instability and systemic risk. Our concerns are shared by the European property industry as a whole and are supported by **EPF**, **EPRA** and **INREV**.

It is vital that EMIR recognises that those with a principal business of developing or investing in land and buildings are non-financial. If it does not do that in a clear and effective way, there is a real risk that the quality of hedging and of liquidity management within the property industry will deteriorate, leading to a build-up of risk for both investors and the banking system that finances the sector.

We would like to stress a specific problem regarding the distinction between financial and non-financial counterparties in the draft regulation. As it stands, many property companies and funds which use derivatives only to hedge against market risks (like interest rates or exchange rates) are likely to be treated as financial counterparties. That is because the definition of "financial counterparty" in article 2(6) of the draft regulation provides that alternative investment funds as defined in the AIFM directive are automatically "financial". Open-end and closed-end property funds would therefore be subjected to the rules for clearing through a central counterparty and for increased margins, unlike other corporate end-users of commercial hedging derivatives.

The real estate sector does not speculate in derivatives. Property businesses use derivates in exactly the same way as other non-financial businesses: to hedge against market risks affecting their commercial activities, and not to generate returns to investors. The tightened requirements which are intended for the financial sector are not justified here and are very likely to be counter-productive. The rules foreseen for non-financial counterparties would sufficiently regulate the risks of these pure hedging transactions. A consequence of the new regulation could be that the use of derivatives by property businesses to provide stability and security against rising interest rates or fluctuating exchange rates will decline sharply in future, or that hedging strategies will change in other unforeseen and unintended ways. Any reduction in market stability in the real estate sector could of course also affect the banking sector which provides finance to property businesses.

The following are our largest member companies or are represented on our Board or Policy Committee:

Allsop LLP
Annington Homes Ltd
Argent Group plc
Aviva Investors
AXA REIM UK Ltd
Bank of Scotland Corporate Banking
Big Yellow Group Plc
The British Land Company PLC
Brockton Capital
Cadogan Estates
Capital & Counties Properties PLC
Capital Shopping Centres Group PLC
CB Richard Ellis
Credit Suisse
Crown Estate
Derwent London plc
Development Securities Plc
Dorrington
Evans Property Group
F&C Property Asset Management plc
Freshfields Bruckhaus Deringer LLP
Frogmore
Grainger plc
Great Portland Estates Plc
Grosvenor
Hammerson Plc
Helical Bar Plc
Hermes Fund Managers Limited
Howard De Walden Estates
Hunter Advisers
Invista Real Estate Management Limited
Jones Lang LaSalle
KPMG LLP
Land Securities Group PLC
Legal & General Property Ltd
Lend Lease Corporation Ltd
Miller Developments Limited
Moorfield Group
Morgan Stanley
Prudential Property Investment Managers Ltd
Redevco UK
Regeneration Investments Limited
Residential Land
Schroder Property Investment Management Ltd
Scottish Widows Investment Partnership Limited
SEGRO plc
St Martins Property Corporation Ltd
St Modwen Properties PLC
Standard Life Investments Ltd
Stockland
Treasury Holdings UK Ltd
Westfield Group
Workspace Group PLC

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We were therefore delighted to note the amendments brought forward in Parliament in order to ensure that real estate businesses are not accidentally included in the financial counterparty definition (amendments 263, 264, 265, 266).

In particular, we strongly support **amendment No. 263** brought forward by Kay Swinburne:

"excluding those businesses whose sole or main strategy or investment policy is to develop or invest in (directly or through its subsidiary entities, co-ownership or joint venture participations) physical real estate."

The words "sole or main" are very important. They are needed to guarantee the protection of real estate businesses which do not only invest in "bricks and mortar" real estate but – to a limited extent and in some cases due to national regulations – also in other assets. Buildings are large, high value assets, each one is unique, and the market in them is slow and illiquid, with significant legal and other transactional costs; buying or selling a building is not like buying or selling bonds, shares or other financial assets.

To guarantee efficient liquidity management, open-ended real estate funds in particular (but other kinds of real estate businesses as well) also invest to a modest extent in other assets besides brick and mortar. The German Investment Law (Investmentgesetz) even prohibits open-ended real estate funds to solely invest (directly or indirectly) in real estate.

Where there is a choice, however, a real estate fund should not have to choose between sensible liquidity management (with a proportion of its funds under management invested, for example, in quoted property shares or debt securities) and a sensible and efficient hedging strategy (which may be impossible if the fund is treated as a financial counterparty by EMIR).

Property businesses (particularly private equity-style closed-end funds) can also be active in other ancillary business segments, for example, managing hotels or other leisure facilities). However, in many cases these other activities are of subordinated significance and do not dilute the fund's real estate focus. The reference point should always be the evaluation of the main investment policy of a business, not of its asset allocation from time to time. A real estate fund or company should be defined as a non-financial counterparty if its business strategy focuses principally on investments in bricks and mortar – contrary to businesses with a broader investment policy which may at times also invest in real estate assets.

We would not expect hedge funds or other non-real estate businesses to have, or to be able to show that they have, a main strategy or policy of developing or investing in bricks and mortar. This is a highly specialised commercial activity involving illiquid assets and requiring detailed expertise in occupier demand and preferences in particular sub-sectors of the real estate market (housing, offices, shopping centres, industrial, etc.). Accordingly, an amendment such as that proposed by Kay Swinburne should not give rise to any material risk of creating a loophole that might be exploited in unintended ways. On the contrary, such an amendment would help deliver stable and secure property markets in Europe in the future.

We understand that the equivalent legislation in the United States is expected to treat the hedging derivatives used by real estate businesses as derivatives of non-financial entities. There is no good reason for Europe to adopt a different approach.

We would be grateful if you could take our comments into account in consolidating real estate related amendments, and in the upcoming vote. Please do not hesitate to call us if you have any queries.

Sincerely yours,

Axel von Goldbeck
Managing Director, ZIA

Peter Cosmetatos
Director of Policy (Finance), BPF

The organisations submitting this letter

The **German Property Federation** (ZIA) was founded by a number of well-known property companies in June 2006. With over 130 members ZIA provides comprehensive and uniform representation of the interests of the real estate industry and is a member of the Federation of German Industries (Bundesverband der Deutschen Industrie). ZIA is also represented in Brussels with an office of its own in order to integrate itself at European level and to advocate the interests of the German real estate industry successfully vis-à-vis the political decision makers in Brussels.

The **British Property Federation** is a membership organisation devoted to representing the interests of all those involved in property ownership and investment. We aim to create the conditions in which the property industry can grow and thrive, for the benefit of our members and of the economy as a whole. Because our membership includes the biggest companies in the property industry - property developers and owners, institutions, fund managers, investment banks and professional organisations that support the industry - we are able to provide the knowledge and expertise needed by legislators (UK and EU) and regulators (including various financial, planning and environmental bodies) in taking their decisions. Our members can help government deliver many of its policies, particularly those involving urban regeneration, sustainable communities, social inclusion, tax-efficient property investment, savings and pensions reform, carbon reduction and environmental improvement.

Organisations expressing support for the views expressed in this letter

The **European Property Federation** represents all aspects of property ownership and investment: residential landlords, housing companies, commercial property investment and development companies, shopping centres and the property interests of the institutional investors (banks, insurance companies, pension funds). Members, which include real estate associations of many EU member states, own property assets valued at €1.1 trillion, providing and managing buildings for the residential or service and industry tenants that occupy them.

The **European Public Real Estate Association** – is the voice of the publicly traded European real estate sector. With more than 200 active members, EPRA represents over EUR 250 billion of real estate assets and 90% of the market capitalisation of the FTSE EPRA/NAREIT Europe Index. Through the provision of better information to investors, improvement of the general operating environment, encouragement of best practices and the cohesion and strengthening of the industry, EPRA works to foster trust and encourage greater investment in listed real estate companies in Europe.

INREV, the European Association for Investors in Non-listed Real Estate vehicles, was launched in May 2003 to act for investors and other participants in the growing non-listed real estate vehicles sector. The non-profit association is based in Amsterdam, the Netherlands. INREV aims to create a forum for the sector and increase the transparency and accessibility of non-listed vehicles, to promote professionalism and clarify best practice and to share and spread knowledge. INREV currently has 355 members drawn from leading institutional investors, fund managers, promoters and advisors across Europe and elsewhere. Investor members in INREV represent real estate assets under management of over €135 billion.