Public Consultation on the Capital Markets Union mid-term review 2017

16 March 2017

About INREV

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property fund industry across Europe.

INREV currently has almost 400 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in Europe.

INREV welcomes the opportunity to comment on the Public consultation on the Capital Markets Union mid-term review 2017. We hope again to provide a meaningful contribution to your work to support the development of a sound regulatory framework and remain available should you have any specific questions about the non-listed fund industry.

B. Making it easier for companies to enter and raise capital on public markets

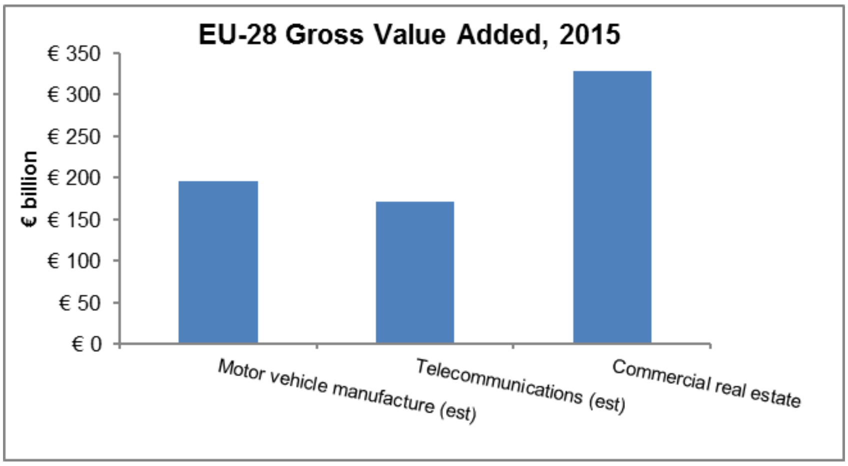
Commercial real estate investment results in providing suitable business space, which is especially important for SMEs. When new and growing businesses can rent space rather than buy it, they gain flexibility and agility in location and employment dynamics required to maximise new opportunities. Renting also frees up available capital, increasing SME's potential to invest in business expansion and R&D, thereby supporting the European economy. Therefore, the recommendations included in section C on Investing for long-term, infrastructure and sustainable investment could significantly support SMEs to enter the market.

C. Investing for long-term, infrastructure and sustainable investment

Contributing to the Real Economy and supporting jobs

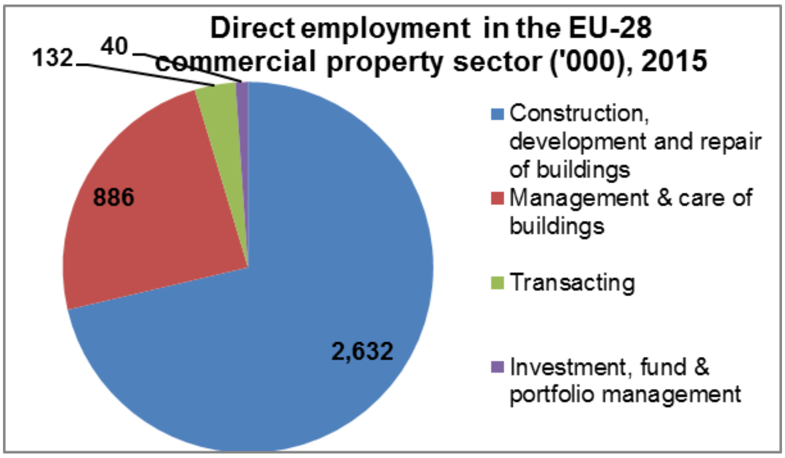
Real estate, as a general term, describes the built environment, which plays a vital role in every aspect of the European economy, society and environment. Businesses and society can't function without the services of commercial property, including the provision of offices, shops, factories, housing and many other forms of real estate. The commercial property sector delivers and manages the infrastructure needed for entrepreneurship to thrive. It is therefore a fundamental source of employment and economic growth, and a major contributor in addressing two critical challenges of our time: providing liveable and functioning cities for a growing urban population, including offering work and office space for SMEs, and reducing the environmental footprint of the built environment.

The commercial property industry directly contributed EUR 329 billion to the European economy in 2015, the last year for which full-year data is available. This figure represents about 2.5% of the total European economy and significantly more than either the European automotive manufacturing industry or telecommunications sector. It directly employs 3.7 million people, which is not only more than the automotive manufacturing industry and the telecommunications sector combined, but also greater than the financial services sector, including banking.



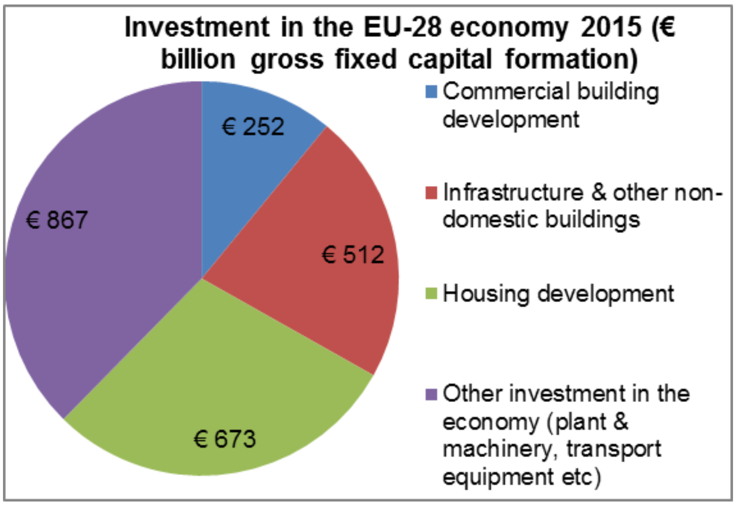
Most activity in the commercial property sector is through the development, refurbishment and repair of buildings. The upkeep, management and care of commercial buildings is also a sizeable activity, undertaken either directly by property owners or on their behalf by a growing number of specialist contractors, many of which are SMEs. These activities are an essential part of maintaining and improving the quality of the accommodation services provided to businesses.

Commercial real estate investment also results in providing of suitable business space, which is especially important for SMEs. When new and growing businesses can rent space rather than buy it, they gain flexibility and agility in location and employment dynamics required to maximise new opportunities. Renting also frees up available capital, increasing SME's potential to invest in business expansion and R&D, thereby supporting the European economy.



Annual investment in new commercial property buildings and the refurbishment and development of existing buildings, much of it done by SMEs, averages around EUR 252 billion. Although recovering moderately over the last few years, the volume is still much lower than 10 years ago and correspondingly accounts for a lower share of total spending on investment in the EU. This highlights how sensitive commercial property investment and jobs in the commercial real estate industry are to the strength of the EU economy. Even so, in representing 10% of total investment in the economy, investment in commercial buildings is equivalent to the GDP of Denmark.

Investment in housing, other buildings and infrastructure is also substantial, totalling EUR 1.2 trillion, and when included with commercial property, represents almost two-thirds of capital investment in the European economy.



Unnecessary regulatory constraints on financing – Solvency II SCRs for Real Estate

We refer here to the Solvency II Directive 2009/138/EC**,** as amended by Directive 2014/51/EU ('Omnibus II'), which introduces economic risk-based capital requirements for insurers across all EU Member States.

The EU's Solvency II directive aims to create a single market for insurance services in Europe. Capital adequacy requirements for European insurance companies are an important part of the regulation; however, Solvency II's inappropriate standard solvency capital requirements (SCRs) for real estate distort commercial decisions regarding investment in real estate. The data used to calculate the standard solvency capital requirement (SCR) for real estate are not based on measures of European-wide real estate values and the resulting SCR does not reflect the actual volatility of European real estate investment across Europe. Internal models, which can be used as an alternative to standard models to develop SCRs tailored to the volatility of insurer's own portfolio, are extremely expensive and time consuming to develop and maintain, and are therefore only an option for Europe's largest insurance companies.

The property sub-module as published in the EIOPA implementing measures establishes a capital requirement equal to the loss that would result from a decrease of 25% in the value of real estate in a single year; however, in using the UK commercial index to derive this figure, the calibration that applies across the EU's real estate markets is based on one of the most volatile real estate markets in the EU.

The UK commercial index used to calculate the SCR for real estate only reflects 20% of the total property investor universe in Europe, does not take institutional residential investment property into account and includes a significant amount of data from one city which are strongly linked to the financial markets there. Furthermore, the UK market has very different lease structures compared to other European markets. In fact, different markets in Europe have very different lease structures, which has a significant impact on valuations.

In addition to the SCR of 25%, the directive sets a correlation between property and equities of 0.75, and 0/0.5 correlation between property and the upside / downside movements in interest rates. These correlations are not derived from statistical data.

In 2011, IPD (International Property Databank, an MSCI company), the institution that produced the data used by EIOPA to calculate the 25% real estate shock factor, carried out an independent study of what they believe a Pan-European real estate shock factor based on more representative data should be. This study includes indices on the property markets of Germany, the Netherlands, France, Switzerland, Denmark, Sweden, Norway, Italy and the UK, and with that more than 80% of the total investor universe in Europe.

The IPD project team created a series of 10-year quarterly indices for all main European property markets, adjusting valuation based indices (VBIs) for the transaction-driven volatility intrinsic to illiquid real estate markets. This new hybrid transaction linked indices (TLIs) revealed clear patterns of extra volatility in most markets, and thus tail values at risk.

When taking the broadest available European market data, and the fullest and latest available evidence of tail values at risk, driven by trading results and professionally supplied valuations, IPD concluded that the 25% real estate shock factor overstates actual real estate value volatility in Europe and could reasonably be reduced to a maximum of 15%.

The IPD review also results in correlations of individual European property markets with equity markets of no higher than 0.50. The fixed income correlations ranged into the negative. These lower correlations from the study are justified given the lagging nature of real estate markets compared to the broader financial markets.

A March 2017 update of the study conducted by IPD/MSCI reaches the same conclusion that 25% real estate shock factor overstates actual real estate volatility in Europe and could reasonably be reduced to a maximum of 15%. Importantly, in light of the UK's expressed intention to exit the EU, the volatility of real estate in Europe excluding the UK does not exceed 12%. A copy of the updated study is attached or can be found at https://www.msci.com/www/research-paper/msci-real-estate-solvency-ii/0605747109**.**

By using an inappropriately high standard SCR for real estate that is not based on more representative data and by using an inappropriately high correlation factor between real estate and equities, Solvency II distorts commercial investment decisions regarding real estate. This result not only limits many insurers' ability to benefit from the diversification benefits of investment in real estate, it also limits their ability to capture the illiquidity premia real estate investment offers. The EU economy and society therefore also lose potential benefits from the higher returns undistorted real estate investment decisions could offer, along with the economic stimulation and job creation that flows from investment in real estate.

In addition, short-term investment behaviour is encouraged by the regulatory assumption underlying Solvency II that illiquid assets such as long-term real estate investments will be used to satisfy insurers' liquidity needs. At the same time, Solvency II's SCRs for real estate based on mark-to-market accounting applied to fluctuations in valuations are pro-cyclical by encouraging the sale of long-term assets in down markets, regardless of the measure of volatility used to determine the SCRs, even when those assets yield long-term, stable income flows through rents. This result is quite ironic when compared to EU Member State sovereign bonds, whose historic volatility in some cases has been extreme; yet these assets are considered to reflect the risk-free rate under Solvency II and the SCR for them is zero.

The Real Estate standard model SCR in Solvency II can be lowered without sacrificing or even diluting the prudential aims that underpin the regulatory starting point, to better reflect the risks of investing in real estate in a wider European context based on better data than the data currently used.

As an alternative to the standard SCRs for asset classes, insurers are able to develop internal models that reflect the actual volatility of their portfolios. However, the extreme complexity and the time and manpower required means in practice that internal models are only a viable option for very large insurers with scale and deep pockets. As a result of an inappropriately high standard SCR for real estate that is not based on more representative data, the gap between the standard model SCR and the SCRs resulting from most internal models is very wide. This results in a competitive advantage for large insurers and creates a barrier to new entrants.

There is little in the way of verifiable empirical evidence available, both because insurers' investment in CRE is relatively intransparent and because Solvency II has come into effect fairly recently and there has not yet been time to assess its impacts. Accordingly, where such data are unavailable, we have deployed our knowledge of the sector, anecdotal information from our members and other industry contacts, and logical, qualitative analysis.

Notwithstanding this point, as mentioned, the extreme complexity and the time and manpower required means that internal models for real estate portfolios are only being developed by very large insurers with scale and deep pockets. Reports of very large teams working for years to develop internal models for larger insurers, which going forward have to be maintained, are common industry knowledge. At the same time, smaller insurers are nearly uniformly balking at the cost and complexity of developing internal models. As a result, the significantly higher solvency capital requirements under the standard model for small insurers for the same real estate assets result in them being forced to side-line greater amounts of capital with lower or no real return, putting smaller insurers at a real competitive disadvantage, and challenging their ability to generate the returns needed to meet their obligations to policy holders.

The costs of developing internal models at the same time create a barrier to new entrants in the insurance market, as only the very largest insurers would be in a position to contest the market share of existing market participants. Needless to say, the competitive advantage to large insurers, combined with barriers to entry and a lack of contestability in the market will result in significant concentration in the provision of insurance products over the long term. Reducing the Solvency II standard model SCRs would also reduce or eliminate the market distortion created by the gap between standard model SCRs and internal model SCRs.

Unnecessary regulatory burdens – AIFMD, EU Merger Regulation, EMIR

AIFMD:

The EU's Alternative Investment Fund Managers Directive (2011/61/EU on Alternative Investment Fund Managers, and relevant implementing measures), which came into full effect in July 2014, established harmonised rules for the management and marketing of all alternate investment funds (AIFs) in Europe. Under the directive, most managers of non-listed real estate funds in Europe are subject to far-reaching and costly requirements regarding their structure and operations and must obtain authorisation from their national financial regulators. Following authorisation, managers may obtain a passport to manage and/or market EU funds in other EU Member States.

Inconsistent interpretation and implementation of some of the directive's requirements by member states create some on-going costs and complexity for non-listed real estate funds. In particular, "gold plating" of some requirements related to obtaining or exercising passporting authority in a number of Member States, including excessive fees and add-on requirements, are a problem. When Member States charge additional fees, they are frequently intransparently calculated, can change randomly and vary widely between those Members States that charge fees. Inconsistent definitions of important concepts such as "professional investor", "material change" and "marketing" among Member States also create unnecessary costs and complexities that significantly reduce the expected benefit of AIFMD.

In addition, certain AIFMD Level 2 measures were also adopted by the Commission that rejected ESMA's recommendation without any explanation, thereby effectively replacing its own judgement with that of the experts without any explanation to the public or the industries affected and without any opportunity for further consultation. This unfortunately also unfairly added costs and complexity that could have been avoided.

There is little in the way of verifiable empirical evidence available, both because institutional investment in CRE is relatively intransparent and because AIFMD is still fairly new and there has not yet been time fully to assess its impacts. Accordingly, where such data are unavailable, we have deployed our knowledge of the sector, anecdotal information from our members and other industry contacts, and logical, qualitative analysis.

Notwithstanding this point, complying with AIFMD has clearly created significant new costs for many fund managers. INREV conducted a survey and asked real estate fund managers to give their views on how AIFMD has affected, and is expected to continue to affect, them. An overwhelming majority answered that the costs of AIFMD implementation are very significant; however, few were able to realise all the anticipated benefits of passporting.

The costs of AIFMD implementation result from revising and adapting remuneration policies and procedures, marketing strategies, investment strategies, and reporting and internal re-organisation. The scale and scope of the new requirements were daunting for many fund managers at the early stages of preparing for AIFMD compliance, with the associated costs being particularly burdensome. The *quid pro quo* for the additional costs of AIFMD is supposed to be the benefits produced from the ability to manage and market funds throughout the EU under an AIFMD passport. However, these benefits have been elusive so far.

In its opinion to the European Commission in July 2015, ESMA acknowledged the still-disappointing results of AIFMD passporting. In particular, ESMA highlighted "gold plating" of some requirements related to obtaining or exercising passporting authority in a number of Member States, including excessive fees and add-on requirements. ESMA also noted that inconsistent definitions of important concepts such as "professional investor", "material change" and "marketing" among Member States, which are creating real obstacles to the smooth functioning of the passporting system in Europe and should be addressed.

As we noted in the Barriers to Cross-Border Marketing consultation, ESMA’s conclusions are consistent with our members’ overall experience with AIFMD passporting to date, which must be characterised as disappointing. It remains unclear which of these add-on requirements are understandable start-up glitches and which are long-term difficulties potentially thinly disguising a desire by Member State regulators to create practical barriers to entry by non-domiciled fund managers authorised in other EU Member States wishing to manage or market funds in their country. In any case, these obstacles indisputably create unnecessary costs and complexities for real estate fund managers.

In contrast to AIFMD, the passport regimes under the EuVECA and EuSEF regulations are a much swifter, less burdensome process. Under the EuVECA and EuSEF Regulations, the EuVECA or EuSEF manager notifies its home Member State competent authority of its intention to manage and/or market an EuVECA or EuSEF, the home competent authority checks the EuVECA or EuSEF meets the requirements of the applicable regulation and notifies the relevant competent authorities in the host Member State. The host Member State competent authorities have no ability to charge the manager additional fees, insist on a detailed review of the application and the fund documents or insist on the appointment of additional, local service providers.

To date, the desired outcome of an open market for AIFMs within the European Union seems far from being realised. The inconsistent and in some cases egregious imposition of fees in order to register and maintain a passport in place, and second, the timing of obtaining a passport when trying to work with the typical launch process for a closed-ended fund that normally requires investors to receive and negotiate draft documents, makes conducting appropriate pre-marketing and finalising documentation in a manner consistent with the passporting process extremely costly, complex and challenging.

Also related to the issues of AIFMD costs, are the directive’s Level 2 regulations, which were developed after lengthy public consultation and careful deliberation by ESMA, including a series of consultation and workshops with stakeholders. The process was efficient, transparent and well managed, with ESMA providing clear explanations for adopting or rejecting stakeholder contributions and recommendations. However, in at least two very notable cases, the European Commission issued Level 2 regulations that rejected specific ESMA recommendations without any explanation, thereby effectively replacing its own judgement with that of the experts without any explanation to the public or the industries affected and without any opportunity for further consultation. This abuse of the public rulemaking process with results that run counter to industry advice and practice, as well as ESMA opinion, unnecessarily has added costs and complexity.

The functioning of the AIFMD passporting system should continue to be improved through more consistent Member State definitions of critical terms. In addition, the "gold plating" and addition of unjustified and intransparently determined fees and requirements by Member States should be prohibited.

It would be a great help to a Capital Markets Union, as well as to European managers and investors, if the AIFMD passport operated in the same way as the EuVECA and EuSEF passports. In order to enhance the Capital Markets Union, it would be helpful if the Commission could provide for one, consistent passport regime by way of a regulation which has direct effect on Member States and that gives no or limited discretion to Member States to gold plate the requirements or charge additional fees.

Related to the development of Level 2 measures generally, where the European Commission deviates in material way from advice given by the European Supervisory Authorities, the European Commission should voluntarily provide or be obliged to provide a detailed explanation to the European Parliament and Council. The explanation should clearly state the reasons for deviating from the original advice and should be made available to the public.

Under AIFMD, there is also a problem created by the limitations on the liability of external valuers under AIFMD article 19(10). In real estate investment, external valuers are a recognised and long-established means of ensuring that the valuation of property held within collective investment vehicles are conducted according to industry standards by qualified, licensed independent third-parties. In many ways, this professional service sector within the real estate investment industry serves as a model for the requirements regarding external valuers under article 19 and the Commission delegated Regulation of 19.12.2012 articles 67-71.

However, property valuers' inability to limit their liability for the services that they perform in rare cases of simple negligence or intentional failure to perform their professional tasks, which they have previously been able to do contractually, has resulted in many or even most of the large valuer firms, including well known established companies, now refusing to accept the external valuer role for real estate AIFMs. This decision has been supported by advice from the sector's major professional body, the Royal Institution of Chartered Surveyors. As a result, real estate AIFMs, especially in a few EU countries such as the UK and Spain, have found it very difficult to obtain the services of any established property valuers, who have taken this position in concert, and many AIFMs have been left no choice but to conduct the valuations internally. This outcome ironically deprives institutional investors with the means of establishing property valuations through these independent third parties, which has been a long-standing good governance practice in the real estate investment industry.

Requirements under the AIFMD such as unlimited liability for external valuers, cash-flow monitoring by depositaries and the definition of closed-end funds make little or no sense for real estate funds but nevertheless must be applied.

The cumulative effect of proposed financial services regulations should be explicitly considered in Quantitative Impact Studies (QISs) or regulatory impact assessments, rather than considering the impact of each proposed regulation in isolation. Furthermore, market distorting incentives created by regulations and their possible unintended consequences should be specifically analysed, while omnibus regulations applying to multiple economic and financial sectors should be replaced by regulations more tailored to each.

EU Merger Regulation:

The EU Merger Regulation, (European Council Regulation No. 139/2004) as it is currently interpreted and applied to real estate investments and co-investments by large institutional investors, including pension funds, sovereign wealth funds and insurance companies, requires that many transactions by 'undertakings' that exceed certain threshold amounts must be reviewed for anti-competitive effect and receive Commission clearance following a mandatory filing process. This review is triggered simply by the size of the investor and can be required if an institutional investor acquires joint control of even a single building through certain types of acquisitions or a co-investment involving a joint venture, club deal, fund or other co-investment vehicle. This is the case, for example, with respect to a business district office building or a shopping centre portfolio investment where there is no realistic likelihood of anti-competitive impact.

The EU Merger Regulation is designed to regulate excessive concentration in European markets and resulting undesirable potential impacts on competition. It requires that certain transactions involving undertakings that exceed specific thresholds be submitted to EU competition authorities for review and clearance before the transaction can take place. Preparation of the submission (including submission of a draft filing in pre-notification discussions), review and receipt of clearance can often take at least 8 to 10 weeks. Clearly, this can be a critically long time period in a competitive commercial environment. As the rules are currently being interpreted, if any two partners in a real estate co-investment are large enough, filing and review are nearly always advised.

Real estate acquisitions were, in our view, never the intended target of the Merger Regulation, but the Regulation is drafted in such a way that it applies in cases where bright-line thresholds related to the size of the investor and legal form of the investment are crossed. As a result, real estate industry practice is to conservatively interpret the regulations and to file for review by competition authorities even when companies are not merging and where it is very clear that no other competitive concerns are triggered.

The delay entailed in preparing and filing for review and receipt of approval by authorities, which is virtually always obtained, is frequently a serious impediment to being able to successfully close a real estate transaction in the time needed. Without having empirical data, our members report numerous instances of investments not being able to take place as a result of the delay involved in review and approval. In addition to being a burden to business with no discernible benefit to regulating anti-competitive behaviour, it is a clear example of excessive compliance cost and complexity.

A clarification that real estate investments and co-investments that might otherwise exceed the Merger Regulation thresholds do not need to be submitted to competition authorities for review and approval would remove this unnecessary burden. Alternatively, adopting a notification procedure to competition authorities for such transactions in place of the current review and approval process could significantly lessen the EU Merger Regulation’s commercial impact.

EMIR:

The EU’s European Markets Infrastructure Regulation, EMIR, (Regulation No. 648/2012/EU on OTC derivatives, central counterparties and trade repositories) establishes requirements related to the use of derivatives, including reporting and in some cases central clearing and cash collateral posting. For real estate fund managers that use interest rate swaps and currency swaps to manage their risk from interest rate and currency fluctuations, the regulation’s requirements can be burdensome and, in some cases, expensive, while arguably offering only marginal benefits to regulators seeking to monitor and control systemic volatility.

While we do not dispute the need for trade reporting for financial firms, we believe that EMIR has created a disproportionate operational and regulatory burden on non-financial firms that enter into derivative contracts for sound risk management purposes. The level of complexity that has been created by EMIR makes it very difficult for small fund managers to understand and comply with the regulation.

In addition, our fund manager members report that the costs involved in checking trade repository data when the reporting obligation has been delegated and the difficulties of understanding the format of the reported data are significant issues. This is especially true for smaller firms trying to comply with the obligation to ensure the accuracy of the data reported by a party to which the obligation has been delegated.

Given the European Commission's Better Regulation Package, which is aimed at designing EU policies and laws so that they achieve their objectives at minimum cost, INREV believes the Commission should seriously consider introducing single-sided reporting for NFCs, at least. Single-sided reporting would lift this burden from non-financial firms, while still allowing regulators to capture the data from these trades from the reports of the counterparty.

If the Commission decides that single-sided reporting is not appropriate, as an alternative we would propose that the Commission consider providing an exemption to the trade reporting requirements under Article 9 for NFC- firms' trades below the ESMA clearing thresholds.

If neither of the changes proposed above is adopted and the Commission continues to require smaller, less sophisticated firms to reporting as now, the measures listed below should be considered to give such firms a realistic chance of complying with in the Article 9 requirements:

- Trade repository data should be made freely available (via login) so that counterparties can check the accuracy of the data that has been reported on their behalf.
- A panel should review the ease of access to trade repositories (including on-boarding and reviewing trade data) and report on whether they are sufficient for smaller NFC- clients.
- Trade repositories should offer simplified position reports so that all firms can easily reconcile the details held at the repository with their own records.

Many or even most NFC- firms in our industry that use OTC derivatives for hedging purposes delegate their trade reporting to their counterparty (the bank). However, banks rarely make the data submitted available to their clients and on-going portfolio reconciliations do not include trade repository data. Under Article 9, of course these NFC- firms remain liable for the accuracy of this data, regardless of any delegated trade reporting agreements they may have entered into. This means that these firms still need to register and 'on-board' with the nominated trade repository to get access to the data and be compliant with Article 9.

However, we understand that very few do this because of the cost and complexity involved. Many struggle with the application form required to request a LEI and the application forms to on-board with a trade repository. Furthermore, when access to the data is obtained, it is not presented in a form that is easily understandable for most NFC- firms.

The regulatory objectives of gathering information about the size and scope of derivative transactions can be effectively accomplished by requiring "single-sided reporting"; meaning only one party to the transaction would need to report it, rather than both. This change would significantly lessen the burden on fund managers, many of which are themselves Small and Medium-Size Enterprises (SMEs), which regulators are looking to assist by lightening the admittedly heavy regulatory burdens on them.

Against this backdrop of complexity and cost, we believe the Commission should consider the insignificant level of systemic risk caused by small, retail firms (as per the definition under MiFID) conducting derivative transactions that are linked to commercial activity or treasury financing.

Other issues:

An issue that does not seem to have been addressed in CMU so far is the problem of inappropriate use of definitions across different regulations. For example, AIFMD provides a definition of AIFMs in Level 1, which is supplemented by implementing regulations, and ESMA Q&As. While the definition is designed for AIFMD, the same definition or the closely related definition of AIFs is used in other European regulations where it is clearly inappropriate and not fit for purpose. EMIR uses the definition of AIFM in its definition of 'financial counterparty', for example, even though EMIR was passed and implemented prior to AIFMD and the final resolution of the definition of an AIFM.

More recently, the European Banking Authority proposed to include all AIFs in the definition of shadow banking, thereby sweeping up most non-listed real estate funds in the proposed scope of that regulation even though most AIFs do not carry out bank-like activities involving maturity transformation, leverage, credit risk transfer or similar activities and do not operate outside a regulated framework.

EMIR, by determining that all AIFMs are per se “financial counterparties”, subjects all AIFMs to the full requirements of the regulation, including central clearing obligations, cash collateral posting, which they would otherwise only have to comply with as non-financial counterparties if they met certain regulatory criteria including exceeding specified thresholds. This requirement has resulted in unnecessary, time consuming and often expensive re-configuration of instruments many real estate fund managers use to manage risk, such as interest rate and currency swaps.

In its 2015 consultation on Shadow Banking entities, the EBA proposed two criteria for determining entities that should be considered shadow banks: a) engaging in credit intermediation activities and b) not subject to robust regulatory oversight. However, going further, while noting that UCITS fund managers are subject to robust regulatory oversight and are therefore not shadow banks, the EBA concluded that all Alternative Investment Funds (AIFs), including real estate funds, are engaged in credit intermediation activities and are not subject to robust regulatory oversight. Thus, it determined that all AIFs should be considered shadow banks.

Luckily, the conclusion that all AIFs are engaged in shadow banking activities did not find its way to the final EBA guidelines issued in December 2015. However, this example serves as a reminder of the irrational results that can flow from the adoption of definitions into new regulations without a full and clear rationale for doing so. The implications of including all real estate funds in the definition of shadow banking activities in terms of potentially reduced flows of capital to this vitally important economic sector would have been immeasurable and easily avoidable.

Another equally problematic situation regarding definitions is the inconsistent definition of terms that are intended to be applied uniformly across the EU. Inconsistent interpretation and implementation of some of the AIFMD’s requirements by Member States create some on-going costs and complexity for non-listed real estate funds. Inconsistent definitions of important concepts such as "professional investor", "material change" and "marketing" among member states currently create unnecessary costs and complexities which significantly reduce the expected benefit of AIFMD.

EU regulatory bodies should not recycle definitions without fully exploring the extent to which they are fit for the new purpose to which they are proposed to be put; there is much to be said for consistent definitions, but only when they are appropriate. AIFMD definitions should not be used without proper consideration, cost/benefit analysis and consultation regarding each affected sector. In addition, when definitions are intended to be interpreted and implemented consistently, EU regulators should encourage a consistent interpretation among Member States.

While INREV welcomes recent initiatives aimed at strengthening long-term investments in the European economy, we note that real estate, which, like infrastructure, can be an attractive asset class for long-term institutional investors, has not received adequate attention and is only mentioned in passing next to infrastructure.

We believe that the distinction and differentiated treatment between real estate and infrastructure is unjustified. It is possible to broadly distinguish between two categories of infrastructure, actually. On the one hand is economic infrastructure, such as communication, transportation, and energy supply networks that typically require planning on a regional scale. Social infrastructure on the other hand includes some forms of rental housing, schools, offices, hospitals, retirement homes, retail facilities, leisure, theatres, sports facilities etc. and is typically more local in nature. There is therefore a large overlap between infrastructure and real estate.

Clearly investments in both types of infrastructure are desirable and necessary and they have much in common. Both are expensive to maintain, upgrade or replace and both are essential elements of our built environment. Securing a steady flow of private sector capital to deliver and maintain them is important, particularly as less capital is available from traditional sources, and as proposed regulatory changes risk creating disincentives to invest in long-term assets.

While economic infrastructure is a relatively well established alternative asset class, some types of social infrastructure are only gradually being explored by the commercial real estate investment sector. The real estate investment industry is increasingly looking beyond its traditional core of retail, office and industrial buildings to invest in social infrastructure projects such as rental housing, student accommodation, leisure and sports facilities, healthcare facilities and care homes for the elderly. Because they can deliver stable, long-term income in much the same way as traditional commercial property, they are increasingly attracting similar, long-term capital.

Like infrastructure, real estate is a long-term asset class as it has no fixed lifespan, but requires specialist management and maintenance, including periodic capital expenditure, if it is to remain operational and fit for purpose over time. This fact means that real estate is also a source of employment that reaches far beyond the construction phase, which combined with the physical assets represents a long-term investment in viable and sustainable communities throughout Europe.

Infrastructure and real estate investments are often mutually dependent, with one not being possible without the other. For instance, real estate assets, as social infrastructure, may not be sustainable in certain areas unless appropriate transport and utilities infrastructure is put in place – while those infrastructure enhancements are unlikely to be financially viable in the absence of substantial investment in the surrounding land.

Given the similarities, mutual dependencies and increasing overlap between different types of infrastructure and the wider world of commercial real estate investment, we believe that both should be addressed in view of their vitally important contribution to strengthening European economy, growth and job creation and receive adequate consideration.

F. Facilitating cross-border investment

All of the points raised in our response to section C would contribute to facilitating cross-border investment, as institutional real estate investment typically occurs cross-border.