PRESS RELEASE

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Reform of EU's Solvency II rules for insurers may trigger surge in European listed real estate investment

Changing EU capital requirement rules for insurers so that listed real estate is treated like direct property investment could result in a sharp increase over time in investment flows to the industry from the continent's largest pool of institutional capital, the CEO of the European Public Real Estate Association said at EPRA's annual conference on Wednesday.

Dominique Moerenhout, EPRA CEO, said: "One of the biggest obstacles to European insurers investing in listed real estate companies is the heavy capital weightings imposed by Solvency II. EPRA is strongly petitioning the European Commission to cut this burden from around the industry's neck under the Capital Markets Union Action Plan and the Solvency II review. Solvency II deters insurance investors from a key source of quality assets and management, liquidity and transparency for their real estate portfolios. If insurers are able to appropriately weight listed real estate in their investment asset allocations, we believe the market capitalisation of the sector in Europe could possibly double."

He added that the regulations also reduce investment in Europe's urban landscape, divert pensioners from a major source of stable retirement income from dividends, restrict job creation and have been a drag on the growth of EU-listed companies relative to their peers in the U.S. and Asia.

The EU's Solvency II rules became fully applicable at the start of 2016 and are designed to ensure that insurance companies can meet their obligations to policy holders in the event of major losses. The rules fix the amount of capital they must hold against their investments for regulatory purposes and these vary according to the risk of potential losses for each asset class. The capital risk weighting required for listed real estate is 39%, along with equities. That contrasts with only 25% for direct property investments, due to the lower perceived risk, or volatility, of physical bricks and mortar.

A large body of academic research has concluded, however, that the performance of listed real estate converges with direct property over the longer term, meaning there is no market rationale for treating the two as separate investment asset classes from a relative risk perspective. In the latest and most comprehensive study conducted by MSCI earlier this year, the researchers found listed real estate sheds the influence of the general equities market after just 18 months, and that there are strong correlations in performance across individual property assets, non-listed funds and securities, particularly over three and five-year periods.

Europe's EUR 10 trillion insurance investment industry is the largest single pool of institutional capital in the EU, but it has very limited exposure to listed real estate. The situation in the U.S. is the opposite and pension funds are the sector's dominant source of investment. Analysts and investors agree that Solvency II plays an important role in the insurance sector's severe underweight allocation to property stocks compared with other forms of real estate investment.

Mark Abramson, Director of the European REIT investment business at Heitman and a member of EPRA's Regulatory Committee, said: "My twenty-something years of experience in the capital markets screams at me that if the risk charge goes down on REITs, then it could unlock hundreds of billions of euros in capital from the insurance industry. Even a fraction of that would be extremely positive for listed real estate in Europe."

Abramson added that the securitisation of real estate through the REIT market had got lost in Solvency II, whereas other investment forms of property are recognised as a unique asset class. He pointed to the convergence of a number of market factors in Europe that could lead to a 'Big Bang' in the listed sector, comparable to the exponential growth witnessed in U.S. REITs in the 1990s:

- Solvency II capital weightings could be significantly revised under the EU's CMU initiative.
- Real estate is likely to be more attractive in a higher inflation environment targeted by central banks as they attempt to 'normalise' global interest rates.
- Listed companies will be in the sights of more generalist investors since the Global Industry Classification Standard reclassification last year, which treats it as a separate equities investment sector.
- The move to defined contribution pension plans in Europe from defined benefit programmes may boost demand for the listed property sector as a higher income asset class.

Stefan Krausch, Head of real estate portfolio management at MEAG, the asset management arm of global reinsurance giant Munich Re, said: "The insurance industry is having a tough time covering its liabilities due to the low yield environment in bond markets and is looking for new investment opportunities. If the Solvency II charge is cut, it could have a very positive effect on insurers. The listed real estate sector has arguably some of the best properties and most qualified management teams, so it is a very interesting and positive investment story. It makes sense to open up the space for insurers."

MEAG is very rare among German insurers in having a sizeable allocation to REITs, totalling more than EUR 500 million, within its real estate portfolio of roughly EUR 11 billion.

Tobias Steinmann, EPRA's Director Public Affairs, concluded: "The European Commission has an opportunity in its review of Solvency II rules to remove a major impediment to the flow of institutional investment capital into the strategically important listed real estate industry. It is precisely this type of barrier to investments and the free movement of capital in the European single market that the Capital Markets Union initiative is intended to eliminate."

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About EPRA

The European Public Real Estate Association is the voice of the publicly traded European real estate sector. With more than 240 members, covering the whole spectrum of the listed real estate industry (companies, investors and their suppliers), EPRA represents over EUR 430 billion of real estate assets* and 86% of the market capitalisation of the FTSE EPRA/NAREIT Europe Index. Through the provision of better information to investors, active involvement in the public and political debate, improvement of the general operating environment, promotion of best practices and the cohesion and strengthening of the industry, EPRA works to encourage greater investment in listed real estate companies in Europe.

**European companies only*

For more information please contact:

Steve Hays, Bellier Financial: +31 (0)20 419 0901, steve.hays@bellierfinancial.com

Kasia Jasik-Caínzos, EPRA: +32 (0)4 78 88 79 08, k.jasik@epra.com