EPRA
EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

VIEWS

September 2017

EPRA Response
to the Questionnaire by the HLG on Sustainable Finance

Background

The High Level Expert Group on Sustainable Finance was set up in early January 2017 to help develop an overarching, comprehensive EU strategy on Sustainable Finance by giving operational, practical, and concrete recommendations. The questionnaire below has been prepared by and under the responsibility of the High-Level Group in relation to the interim report, published in mid-July 2017 and presented at a stakeholder event on 18 July 2017. It is aimed at gathering targeted feedback on the analysis and reflections in the interim report of the High-Level Expert Group and informing the preparation of the final report.

EPRA responded to the questionnaire and took the opportunity to provide an input needed to help improve the conditions of the listed property sector. It is our view that the European listed property investment companies:

- provide transparent investment opportunities with healthy corporate governance and accountability (as part of regulated stock markets)
- provide much needed liquidity to an otherwise illiquid market
- deliver solid long-term, diversified returns to their shareholders/investors
- provide comparable financial (EPRA BPRs - November 2016) and non-financial information (EPRA Sustainability BPRs - September 2017) based on the industry developed Best Practice Recommendations.
- outperform other property sectors when it comes to environmental performance of their portfolios (see GRESB survey 2016).

These characteristics of the listed property investment sector make them an important (if not essential) part of any real estate portfolio as they have a positive effect on the rest of the property sector and also on the quality of the built environment.

It is therefore important to proactively enable investors to invest in the good quality long-term assets and to do so in a more sustainable way. Listed real estate is one of the asset class that should be further looked at.

EPRA opinion:

Question 1. From your constituency's point of view, what is the most important issue that needs to be addressed to move towards sustainable finance? (sustainable finance being understood as improving the contribution of finance to long-term sustainable and inclusive growth, as well as strengthening financial stability by considering material environmental, social and governance factors)

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EPRA represents the publicly traded real estate investment sector which is an important source of accessible and long-term investment opportunities. The listed property companies drive up standards and efficiencies in the broader property market which in turn improve the broader property sector's contribution to the economy.

They:

- provide transparent investment opportunities with healthy corporate governance and accountability (as part of regulated stock markets)
- provide much needed liquidity to an otherwise illiquid market
- deliver solid long-term, diversified returns to their shareholders/investors
- provide comparable financial (https://goo.gl/3bDPGP) and non-financial information (https://goo.gl/wDAUov) based on the industry developed Best Practice Recommendations.
- outperform other property sectors when it comes to environmental performance of their portfolios (see GRESB survey 2016 https://goo.gl/DzQWe6).

These characteristics of the listed property investment sector make them an important (if not essential) part of any real estate portfolio as they have a positive effect on the rest of the property sector and also on the quality of the built environment. That said, it is important to proactively motivate investors to invest in the long-term assets (incl. real estate) and to do so in a more sustainable way (incl. listed real estate) while removing the existing regulatory obstacles which disable the sector to grow (https://goo.gl/GHnRgC).

Develop a classification system for sustainable assets and financial products

Question 2. What do you think such an EU taxonomy for sustainable assets and financial products should include?

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As mentioned above, we consider investing in real estate as investing in long-term investment asset class out of which listed real estate is managed in a more transparent and more sustainable way. As a result, we recommend the HLEG on Sustainable Finance to consider listed property investment companies (including REITs) as a sustainable asset class in a long-term.

Regarding the scaling of the sustainable challenge, we would like to refer to Box 1: Green Finance: a subset of the sustainable finance agenda (at p. 12 of the Interim Report). Having that in mind, we would recommend addressing the listed real estate investments in the illustrated stages: starting from "Low-Carbon", through "Green" to "Sustainable" investments. We would also recommend the HLEG not to stop at Green but to start considering how to finance better the "Sustainable" assets, and these would include tacking risks of poor governance.

The above suggestions could help to mobilise capital for sustainability priorities (e.g. tackle climate change through green buildings – renovations and new construction) across the financial system.

Establish a EU standard and label for green bonds and other sustainable assets

Question 3. What considerations should the EU keep in mind when establishing a European standard and label for green bonds and other sustainable assets? How can the EU ensure high-quality standards and labels that avoid misuse/green-washing?

1500 characters maximum (spaces included)

We welcome proposals to define EU standards for green bonds and other sustainable assets. With regards to bonds, we recommend not to limit their definition to environmental aspects but to include also other initiatives related to sustainability, such as social bonds, sustainable bonds which impact society (e.g. social housing, nursing homes). In addition, bonds are primarily a re-financing instrument, hence they should be promoted as one of the main tools for renovation of existing assets, especially for the listed property sector.

Below are a few examples of our Members:

a) Green & Social Bond - Cofinimmo

It aimed to (re)finance buildings already delivered, renovated, or under redevelopment: projects with an environmental goal and also projects with social goals, i.e. healthcare assets used for the accommodation of vulnerable people. More at https://goo.gl/v9eUtg.

b) Green Bond - Unibail-Rodamco

Unibail-Rodamco issues Green Bonds to finance brownfield and/or existing assets which meet strong and selective criteria. The criteria have been developed with and validated by Vigeo and cover social, environmental and sustainable areas both during the construction and the operating phases of assets. The compliance of Unibail- Rodamco's "best-in-class" assets which have been chosen for the allocation of Green Bond proceeds is verified each year by a third party auditor (more at https://goo.gl/voJd3d).

c) Green Bond – Foncière des Régions (more at https://goo.gl/uHr4su).

Create "Sustainable Infrastructure Europe" to channel finance into sustainable projects

Question 4. What key services do you think an entity like "Sustainable Infrastructure Europe" should provide, more specifically in terms of advisory services and connecting public authorities with private investors?

1500 characters maximum (spaces included)

EPRA has no comments.

Mismatched time horizons and short-termism versus long-term orientation

Question 5. It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement?

- ○ **Yes**
- ○ No
- ○ Don't know / no opinion / not relevant

Question 5.1. If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to resolve or attenuate this conflict?

1500 characters maximum (spaces included)

As demonstrated by "Listed and private real estate: Putting the pieces back together" (https://goo.gl/Vqqt61), listed real estate is one of the sectors affected by the mismatch between short and long-term horizons. The MSCI/EPRA report shows that over shorter measurement periods - of up to around 18 months - the cost of increased liquidity for listed property companies comes in the form of additional volatility. Beyond this 18-month window, however, the research reveals how the performance track records for listed real estate - at both company and market levels - converge closely with those of corresponding directly held assets as the benchmark period approaches the 3-to 5-year mark. This shows that listed real estate correlates with direct property in the long-term, yet, it is often treated (incorrectly so) as equity.

Under Solvency II, the look-through approach should be available for investments to listed property investment undertakings. Insurers would thus look at the substance of the investment rather than its form (which is real estate and not equity – as supported by research).

To further promote long-term investments (LTIs) in real estate would mean looking at a cross-border tax treatment of REITs. Mutual recognition, if not harmonisation, of REIT regimes in the EU would be a solution. Next to that, the EU should be looking at how withholding tax can impair investments across border.

Governance of the investment and analyst community

Question 6. What key levers do you think the EU could use to best align the investment and analyst community with long-term sustainability considerations in the real economy?

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This issue could be addressed through corporate governance codes (applicable for stock-exchange listed companies) aimed to promote integration of sustainability considerations into the strategy of the governance bodies of firms, institutional investors and funds.

In this regard, EPRA welcomes the recommendations suggested by the HLG, and in particular:

- Explicit board responsibility for sustainability, including capacity to determine long-term materiality from a wider perspective in terms of both stakeholders and non-financial aspects.
- A board sustainability committee in certain industries or for firms above a certain size.

A strong pipeline of sustainable projects for investment

Question 7. How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?

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EPRA welcomes any initiative that aims to boost long-term investments and to diversify sources of funding of sustainable projects.

In particular, for listed real estate sector, EPRA would recommend policy makers to consider:

- Line of credit: For example, EPRA member has recently obtained a credit from the EU for modernisation capex and signed a €300 million 8-year unsecured credit line with the European Investment Bank (EIB) to finance energy-efficient housing upgrades. The loan is backed by a guarantee from the European Fund for Strategic Investments (EFSI).
- Green mortgages (as per EMF's position)
- Gradual decrease of solvency capital requirements for energy efficient, green, and sustainable assets under Solvency II.

Integrating sustainability and long-term perspectives into credit ratings

Question 8. What are some of the most effective ways to encourage credit rating agencies to take into consideration ESG factors and/or long-term risk factors?

Please choose 1 option from the list below

- ○ Create a European credit rating agency designed to track long-term sustainability risks
- ○ Require all credit rating agencies to disclose whether and how they consider Task Force on Climate-related Financial Disclosures (TCFD) related information in their credit ratings
- ○ Require all credit rating agencies to include ESG factors as part of their rating
- ○ All of the above
- ○ Other

Question 8.1 Please specify what other ways you would deem most effective in encouraging credit rating agencies to take into consideration ESG and/or long-term risk factors.

1500 characters maximum (spaces included)

EPRA considers the option number 1 (Create a European credit rating agency designed to track long-term sustainability risks) as the most effective way in the short-term, and then the option number 2 (Require all credit rating agencies to include ESG factors as part of their rating) at the most effective method in the long-term.

Role of banks

Question 9. What would be the best way to involve banks more strongly on sustainability, particularly through long-term lending and project finance?

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Investment banks should be required, when advising to investors on sustainable investments, to base their recommendations on ESG criteria/rating. They should be able to demonstrate how they have taken them into consideration. For example, when advising on real estate asset allocation, they should be able to demonstrate that the recommended real estate investments are more sustainable.

Investors in publicly listed property companies are able to access the income and capital returns generated by commercial property in a form which is transparent, well and internally governed and liquid. For investors in REITs, which generally include an obligation to distribute the majority (typically 90%) of income to investors each year, the close relationship to direct property returns is enhanced further due to the tax transparency of the REIT investment vehicle. The liquidity provided by listed property companies and REITs through stock market quotation does not change the property return profile over the medium to long term. In fact, the REITs market is more quick and efficient in terms of the response to changes in fundamentals affecting property, than the direct property market (more at https://goo.gl/MkU6ae and https://goo.gl/r1iqhT).

Adding more listed real estate to the overall real estate asset allocation would, in our view, not only help diversify real estate investments but also increase sustainability of the overall property markets.

Role of insurers

Question 10. What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?

1500 characters maximum (spaces included)

As mentioned in Q5.1, listed real estate is under Solvency II considered as equity. It is our strong view that the look-through approach should be available for investments to listed property investment undertakings. We would therefore suggest that the HLG, European Commission and EIOPA look at the substance of the investment rather than its form. In the case of listed property investment undertakings, it would be in the medium-to-long term real estate and not equity.

More information at https://goo.gl/JKLupZ.

Social dimensions

Question 11. What do you think should be the priority when mobilising private capital for social dimensions of sustainable development?

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Listed property companies are important actors of society, mindful of the long-term interests of communities in which they operate. They are willing to take a role in improving life standards while doing business and the shareholders' returns. Urban redevelopment, sustainability leadership and social needs awareness demonstrate how critical the built environment is in achieving social objectives and how listed property companies play an important role in achieving these.

Listed property companies are making targeted investments in projects that benefit communities, such as:

- Nursing homes & healthcare (Cofinimmo, Care Property Invest, MedicX Fund, Assura, Target Healthcare REIT)
- Neighbourhood redevelopment (Vonovia, British Land),
- Student housings (GCP Student Living, Empiric Student Property, Unite Group, Xior Student Housing)

Listed property companies also promote programmes of social inclusion and skills development, e.g.:

1) GCP Social Worker Program, promoted by Grand City Properties aims to support the tenants in their individual social and financial situations (i.e. in handling job-centre requests, immigration status, severely-handicapped certificates, cost take-over documents, and other requests which require special knowledge).

2) Community Employment Programme (CEP) by Landsec, enables individuals from some of the most vulnerable sections of society, arguably those who find themselves at the greatest distance from job opportunities, to find meaningful employment.

Other

Question 12. Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?

1500 characters maximum (spaces included)

EPRA is also aware that the main challenge for the benchmarks and indices is to identify underling risks related to a firm operation. Indices and benchmarks need to apply a much broader understanding of value creation and look beyond direct impacts to tracking the underlying behaviours that preserve value throughout the company. For this reason, EPRA believes that integrated reporting should be another measure to promote, as it encourages companies to explore the dependencies and relationships that connect the capitals, and also the trade-offs between them (such as short-term performance vs. long-term impact). Please refer to “The missing glue in ESG” at pp. 24 of the EPRA Magazine issue 52 at this link https://goo.gl/56Y4mK.

Question 13. In your view, is there any other area that the expert group should cover in their work?

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Considering that buildings are responsible for 40% of energy consumption and 36% of CO2 emissions in the EU, it’s surprising not to see any reference to real estate sector in the Interim Report. Listed property sector outperforms non-listed sector in its environmental performance. It implies that investments in listed property companies (incl. REITs) are greener than any other investments in real estate.

Given the governance requirements for all EU listed companies, and transparency provided by both financial and non-financial reporting of EPRA members, we would refer to the listed property investment companies as the most sustainable form of investments in real estate which is also accessible to all investors.

We truly believe that the HLG should look at the sector and recommend measures to remove the obstacles met by investors when investing in real estate through publicly listed companies, including REITs.

We would also recommend reviewing EPRA position on CCCTB (https://goo.gl/M18SVf) as this legislative proposal, although much welcomed, does not address the particularities of the listed EU REITs. We suggest addressing various tax aspects of the EU REITs in a separate exercise, either by harmonisation or approximation of the EU REIT regimes (e.g. EC Recommendations, Best Practice). Alongside, the EU should be looking at how withholding tax can impair REIT investments across the EU.