EPRA REPORTING

European Public Real Estate Association

EPRA Cost Ratios (BPR)

July 2013

For any questions or feedback related to the BPR, please contact:

Gareth Lewis, *Director of Finance*

Mohamed Abdel Rahim, *EPRA Financial Reporting Manager*

EPRA
Square de Meeus 23
B-1000 Brussels
Belgium

Email: info@epra.com
+32 (0)2 739 1010

The following guidance will be incorporated into the Section 3 of the updated BPR which is expected later this year. For now, this is a standalone document.

3. EPRA Performance Measures

3.6 EPRA Cost Ratios

Issue:
EPRA has received feedback that investors and analysts would like to see more transparency over operating costs incurred by property companies – including overheads capitalised, joint venture expenses and management fees.

Rationale:
In order to encourage the provision of clearer and more comparable disclosure of total costs, EPRA has developed guidance for reporting two EPRA Cost Ratios which can be calculated on a consistent basis for property investment companies whose primary business is the long-term ownership, leasing and management of investment property for the accumulation of rental income and capital appreciation.

The purpose of these ratios is to reflect the relevant overhead and operating costs of the business and provide a recognised and understood reference point for analysis of a company's costs. EPRA recognise that there is a wide spectrum of sectors and business models that have long term ownership and management of property as their core activity. This fact, combined with limited requirement by IFRS regarding the classification of operating, administration, overheads and capital costs, results in difficulties in providing clear and consistent information to investors.

The EPRA Cost Ratios are aimed at providing a consistent base-line from which companies can provide further information around costs where appropriate. The EPRA recommendation therefore includes suggestions for how companies might provide this additional information.

The EPRA Cost Ratios are not intended to be used to directly compare with other industry sectors like the unlisted fund sector. INREV recommendations such as the Total Expense Ratio (TER) do not include property expenses and management "performance fee" costs and are not comparable to the EPRA measure, which includes all property expenses, management fee costs and remuneration.

Recommendation:
Real estate companies should publish both "EPRA Cost Ratio (including direct vacancy costs)" and "EPRA Cost Ratio (excluding direct vacancy costs)". Companies should disclose the full calculation in a manner consistent with Table E and the recommendations below:

- The full names (as described above) should be given to the respective measures, whenever used.
- Companies should disclose both measures within their Annual Report and are encouraged to give equal prominence to both measures (for example disclosing both in any EPRA KPI summary table). However, companies are not required to disclose both every time a cost ratio is referenced in the report.

The EPRA Cost Ratio (including direct vacancy costs) should include all administrative and operating expenses in the IFRS statements including the share of joint ventures' overheads and operating expenses (net of any service fees).

- Service fees and management fees should be netted against costs excluding any actual/estimated profit element. Other income/recharges which relate to, or are specifically intended to cover overhead and property expenses, should also be included if these are significant.

- Operating expenses include all property costs which are taken through the income statement such as bad debt expenses, maintenance expenditure, development costs written off, and non-recoverable costs. However, investment property depreciation, ground rent costs and vacancy costs should be excluded (deducted from the reported IFRS costs).
- Operating expenses not recharged specifically to tenants but which are *de facto* included in the rents should also be excluded from operating expenses.

The EPRA Cost Ratio (excluding direct vacancy costs) should be calculated as above, but with an adjustment to exclude vacancy costs (see **ix** in explanation of adjustments below).

Both EPRA Cost Ratios should be calculated as a percentage of Gross Rental Income less ground rent costs (including share of joint venture Gross Rental Income less ground rent costs).

- Operating expenses not recharged specifically to tenants, but which are *de facto* included in the rents, should also be deducted from Gross Rental Income for the same amount as the deduction from the expenses (see above).

EPRA also encourages companies to provide additional information on the full (i.e. nominal) amount of overheads and operating expenses capitalised (even if these are nil) and explain their policy with respect to capitalising overhead and operating expenses.

E. EPRA Cost Ratios		NAV in thousands euro/pounds etc
	Include:	
(i)	Administrative/operating expense line per IFRS income statement	x
"	" " " "	x
"	" " " "	x
(ii)	Net service charge costs/fees	x / (x)
(iii)	Management fees less actual/estimated profit element	(x)
(iv)	Other operating income/recharges intended to cover overhead expenses less any related profits	(x)
(v)	Share of Joint Ventures expenses	x
	Exclude (if part of the above):	
(vi)	Investment Property depreciation	(x)
(vii)	Ground rent costs	(x)
(viii)	Service charge costs recovered through rents but not separately invoiced	(x)
	EPRA Costs (including direct vacancy costs) (A)	**xxx**
(ix)	Direct vacancy costs	(x)
	EPRA Costs (excluding direct vacancy costs) (B)	**xxx**
(x)	Gross Rental Income less ground rent costs	x
(xi)	Less: service fee and service charge costs components of Gross Rental Income (if relevant)	(x)
(xii)	Add: share of Joint Ventures (Gross Rental Income less ground rent costs)	x
	Gross Rental Income (C)	**xxx**
	EPRA Cost Ratio (including direct vacancy costs) (A/C)	**%**
	EPRA Cost Ratio (excluding direct vacancy costs) (B/C)	**%**
	Additional Recommended EPRA Disclosure	
	* Overhead and operating expenses capitalised (incl. share of joint ventures)	x
	* Companies should clearly explain their policy with regard to overheads capitalised even if they do not disclose the amount of overhead capitalised or disclose a nil amount (see explanation below)	

Companies are encouraged to use the EPRA Cost Ratios as a base-line to provide additional disclosures, where appropriate, on costs in the context of their own business model. For example, companies might provide a reconciliation between the EPRA Cost Ratio and a cost measure based on a Gross Asset Value (GAV) denominator; a cost measure which excludes costs of development or an 'administration' cost measure.

Explanation of Adjustments

(i) Expense lines

Include all of the 'overhead' and 'operating' expense lines (including property-related expenditure) in the IFRS Income Statement between revenue and the net operating result. Service charge expenses should be recorded net of service charge fees (see item **ii**).
For the avoidance of doubt the following costs are excluded:
- Corporate income tax
- Fair value gains/losses
- Discounts on acquisition/goodwill impairments
- Finance costs
- Gains/losses on sale of properties & disposals

Companies should not exclude items purely because they are considered 'exceptional'.

(ii) Net service charge costs/fees

Service charge fees/recharges should be deducted from service costs.

If the company has rent which includes operating expenses not recharged specifically to tenants (e.g. 'warm' rents – a common practice in Nordic countries, and property costs which are included in the rents but which are not rebilled directly under the triple-net lease market practice), adjustments should be made to offset the service income against service costs and deduct this income from Gross Rental Income in **(viii)** and **(xi)** below. Both of the adjustments should be limited to the extent that the cost equals revenue. Any profit or loss related to under/over-billing of, for example, energy costs, should therefore be taken into account in the ratio.

(iii) Management fees less actual/estimated profit element

Management fees receivable should be netted against costs in arriving at the EPRA Cost Ratio. In the business model of a typical listed property investment company, management services are not generally a significant profit generating part of the business. These fees are typically intended to offset costs.

Any profits from management fees should be excluded. The reasoning behind this is that netting such profits against costs would not give a fair reflection of the overhead and operating costs of the business.

(iv) Other operating income/recharges intended to cover costs less any related profits

Where companies receive other operating income/recharges that are specifically intended to cover overhead and operating expenses then these should be deducted. Any related profits element should also be excluded.

(v) Share of joint venture expenses

Add the share of joint venture administrative and operating expenses not already included e.g. because the company applies the equity method of accounting.

(vi) Investment Property depreciation

Deduct Investment Property related depreciation where the company applies the cost method of accounting.

(vii) Ground rent costs

Any ground rent costs should be excluded from costs and also deducted from the gross rental income (item x). This is to ensure that property companies that hold leasehold properties (vs. freehold) are not unfairly penalised.

(viii) Service charge costs recovered through rents but not seperately invoiced
See (ii) above.

(ix) Direct vacancy costs
The EPRA Cost Ratio (excluding direct vacancy costs) deducts all vacancy costs related to standing assets or to investment properties undergoing development/refurbishment if they have been included in expense lines (i). The costs that can be excluded are property expenses that are directly related to the property including the following:

- Rates/property taxes
- Service charges
- The relevant units' contributions to the tenant association's share of marketing costs
- Insurance premiums
- CRC - carbon tax
- Any other costs directly billed to the unit e.g. individually metered energy bills

(x) Gross Rental Income less ground rent costs
Gross rental income should be calculated after deducting any ground rent payable.

All service charge fees/recharges/management fees and other income in respect of property expenses should not be added to gross rent but should be deducted from the related costs. If the rent covers service charge costs, then companies should make an adjustment to exclude these.

Tenant incentives which are treated as part of rent averaging under IFRS (e.g. cash incentives) should be deducted from rental income, whereas any other costs should be included in costs. This is in line with IFRS requirements.

(xi) Service fee and service charge costs components of Gross Rental Income (if relevant)
See (ii) above.

(xii) Share of joint ventures (Gross Rental Income less ground rents)
Add the share of joint venture rent (after ground rents) not already included e.g. because the company applies the equity method of accounting.

Explanation of Additional Recommended Disclosure

Overhead and operating expenses capitalised
As an additional disclosure, EPRA recommends that companies disclose the amount of any directly attributable overhead and operating costs capitalised during the year (even if nil). These are costs that would normally be classified as overhead or administrative costs (predominantly staff costs). The disclosed amount should include the proportionate share of joint venture costs capitalised in this manner.

In addition to the disclosure of the amount of overhead and operating costs capitalised, a company should clearly explain which of the following scenarios best describes its policy regarding capitalising of overheads; either in the EPRA note or as part of the accounting policy note (to the extent permissible under IFRS):

a) The company has a policy of capitalising overhead and operating expenses and what types of costs are capitalised (e.g. legal fees, development staff, etc)
b) The company does not have any overhead costs capitalised. In this case it should explain the reasons for this, for example:
   - it has a policy of not capitalising any overhead and operating expenses
   - it has no assets under development
   - it uses third-party service providers for its development activity and/or acquires assets directly from third party developers

Capital expenditure (e.g. construction/redevelopment costs, equipment, fixtures & fittings) should not be included in this figure.

EPRA Reporting & Accounting Committee and Working Group

Committee members:

Martin Greenslade (Chairman), *Land Securities*

Jean-Michel Gault, *Klepierre*

Jaap Tonckens, *Unibail Rodamco*

Olivier Elamine, *Alstria*

Giacomo Balzarini, *PSP*

Ben Van der Klift, *Corio*

Tom de Witte, *Vastned*

Daniel van Dongen, *Wereldhave N.V.*

Evert Jan van Garderen, *Eurocommercial Properties NV*

Ulrika Danielsson, *Castellum*

Birgit Noggler, *Immofinanz*

David Doyle, *Atrium Real Estate*

Marc Hellemans, *Cofinimmo*

Justin Reid, *Segro*

Warren Austin, *Hammerson*

Lucinda Bell, *British Land*

Nick Sanderson, *Great Portland Estates*

Marcus Koch, *DIC Asset*

George Yungmann, *NAREIT*

Hans Op 't Veld, *PGGM*

Dick Boer, *Kempen*

Oliver Puhl, *Morgan Stanley*

Rogier Quirijns, *Cohen & Steers*

Harm Meijer, *JP Morgan*

Hans Grönloh, *KPMG*

Pierre-Hugues Bonnefoy, *Deloitte*

Jean-Baptiste Deschryver, *PWC France*

Ad Buisman, *Ernst & Young*

Gareth Lewis, *EPRA*

Participants in the Working Group:

Harm Meijer (Chairman), *JP Morgan*

Hans Gronloh, *KPMG*

Warren Austin, *Hammerson*

Jean Luc Neez, *Unibail-Rodamco*

Evert Jan van Garderen, *Eurocommercial Properties NV*

Despina Don Wauchope, *Land Securities*

Simon Carlyon, *Segro*

Rob Hudson, *British Land*

Olivier Elamine, *Alstria*

Dick Boer, *Kempen*

Hans Op 't Veld, *PGGM*

Martin Carlsson, *Castellum*

Gareth Lewis, *EPRA*

Mohamed Abdel Rahim, *EPRA*

EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

Square de Meeus 23
B-1000 Brussels
Belgium

T +32 (0)2 739 1010
F +32 (0)2 739 1020
www.epra.com