



Open Ended Real Estate Funds

15 April 2008

As you may be aware, the Expert Group Report (the “Report”) on open ended real estate funds (“OEREFs”) was published on 13 March 2008. This article aims to give a high level summary of the principle objectives of the Report and the recommendations made by the Expert Group (the “Group”).

Mandate of the Group

The Group was appointed by the European Commission to advise it by way of a report setting out clearly evidenced analysis and recommendations in respect of the following issues:

- (i) the risk and performance characteristics of OEREFs;
- (ii) the scale and scope of the perceived benefits for the industry and for investors of introducing an EU-wide passporting mechanism for OEREFs. In doing so the Group would provide
 - a description of the European market for real estate funds, including open ended funds
 - an analysis of the existing or likely future demand for providing OEREFs across borders
 - an examination of the barriers to cross-border development of OEREFs across borders;
- (iii) an evaluation of existing national regulatory (including tax) approaches in respect of OEREFs; and
- (iv) cost-effective options and solutions for creating a Single Market framework for cross-border marketing or management of OEREFs.

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The purpose of OEREFs is to package real estate assets in the form of a traditional regulated investment fund. There are over €110 billion of assets now managed by European OEREF managers that are primarily designed for the retail market and in turn retail investors. OEREFs offer investors (i) exposure to the real estate asset class with fund performance characteristics which are closely correlated with current real estate market values, as well as (ii) the possibility to redeem their investments at regular intervals, with unit prices based on the underlying value of the real estate assets held within the portfolio. Real estate assets cannot be traded as easily and as cheaply as some other asset classes. Real estate is therefore generally viewed as a long-term investment.

Recommendation 1

EU policymakers should create a new regime for OEREFs, to facilitate the cross-border offer of OEREFs to retail consumers. In the opinion of the Group, only an EU passport can create a Single Market for OEREFs. The Group concluded that the best way to achieve this outcome is to establish an EU-wide passporting system based on common rather than country by country regulations. These rules could be implemented in all Member States. The Group recommends that this regulatory approval mechanism should be modelled on the UCITS Directive.

Recommendation 2

In the opinion of the Group, legislative action at the European level is required in order to overcome existing regulatory barriers to the marketing of OEREFs across borders. A clear set of binding rules could bring about the legal certainty needed for opening the currently sealed off markets for the cross-border distribution of foreign OEREFs to retail investors. The development of an EU regime would allow asset managers and consumers in all 27 Member States to benefit from new investment and business opportunities.

Recommendation 3

The Group concluded that a modification of the UCITS Directive to provide a product passport for OEREFs would be the most efficient way to achieve cross-border OEREF distribution to the retail market. This option would ensure that OEREFs could be readily marketable through existing distribution channels. The Group advises that all rules relating specifically to

OEREFs should be drafted according to the Lamfalussy procedures, whereby high-level principles would be established, with detailed implementing measures undertaken at a second level in conjunction with Member States' authorities. If such an approach cannot be delivered for technical or political reasons, the Group recommends a stand-alone directive for OEREFs as a second best option.

The Group proposes a set of key features which could form an effective regime for EU OEREFs. The Group's analysis of different national regimes and UCITS rules identifies strong arguments for adding OEREFs to the UCITS Directive. Most national regimes that have already integrated OEREFs into national regulations have done so in a similar manner to the implementation of UCITS.

Key Features

There are six key features without which OEREFs would not be able to effectively function or without which investor protection would be insufficient. The Group recommends the following:

- (i) OEREFs should have the possibility to make full use of property Special Purpose Vehicles;
- (ii) OEREFs should be permitted to borrow up to 60% of their real estate (including real estate SPV) assets;
- (iii) OEREFs should redeem units at investor request, which may be on a daily basis, but could be as infrequent as once in a quarter;
- (iv) OEREFs should maintain a minimum liquidity of 10% of their assets and install a sophisticated liquidity management system appropriate to their subscription/redemption policy;
- (v) Properties held within an OEREF portfolio should be subject to independent and regular valuation at least once per calendar year to determine a market value of the properties, based on international valuation standards; and
- (vi) OEREFs should fully disclose their pricing policies. They should also highlight to investors the long-term investment focus of OEREFs and that the redemption of units may be suspended under exceptional circumstances.

Tax Recommendation

Foreign OEREFs are taxed in a discriminatory way compared to domestic OEREFs. While domestic OEREFs are usually tax exempt at the fund level, tax authorities refuse to grant the same status to foreign OEREFs. Moreover, in several Member States, national tax law discriminates investors in foreign OEREFs over investors in domestic OEREFs. Both barriers result in distorted competition. Given this situation and the complexity to achieve a common tax framework, the Group recommends a pragmatic approach. In light of the EU treaty freedoms, notably the free movement of capital, it reminds Member States of the prohibited discrimination of foreign OEREFs and invites the EU Commission, if need be, to enforce these freedoms.

Timing

There is currently no timetable available for when the EU Commission or policymakers may respond to the Group Report, or for implementation of an OEREF regime. It is unlikely that this would begin until 2009.

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Katten

Katten Muchin Rosenman Cornish LLP

www.kattenlaw.co.uk

1-3 Frederick's Place • Old Jewry • London EC2R 8AE
+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

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