



05 May 2015

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By email: cp15-08@fca.org.uk

Dear Matteo

CP 15/8: Question 4.1: Questions and answers on the valuation obligations under AIFMD

The Association of Real Estate Funds (AREF) is the voice of the UK real estate funds industry and has about 65 member funds with a collective net asset value of £55 billion under management on behalf of investors, including about £25 billion of net asset value in UK-authorized retail funds (NURS) and unit-linked pension funds. AREF is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Pooled Property Funds Indices and the AREF/IPD Property Fund Vision Handbook. A condition of AREF membership is compliance with the Code of Practice on transparency.

AREF welcomes the proposed questions and answers on the valuation obligations under AIFMD and generally agrees with the clarifications they provide. In particular we agree with the principle of defining the valuer by reference to the final determination of an asset's value and that a valuation committee's seniority and competence should be assessed on a collective basis. However, we are concerned that certain key aspects of the proposals will cause serious difficulties for some property fund managers, as explained below:

Fund constitution incompatible with surveyor engagement

We agree with the clarification that the valuer can take advice from other contributors such as a valuation adviser and this is particularly pertinent for property funds given the involvement of independent surveyors in the valuation process. Nevertheless we are seriously concerned about the implications of the fact that the constitutional documents of a significant number of property funds effectively require that a valuation recommended by a surveyor is binding on the AIFM (and all investors). On the face of it this would appear to make the surveyor an "external valuer" as envisaged by the AIFMD. However, a number of our members have been told by their independent surveyors that they are not willing to be engaged as external valuers, and those who might be willing are indicating that their costs would increase dramatically. We are aware from our recent discussions with RICS (representatives of the surveyor community) that there are two key reasons for this:

- Many firms of surveyors take the view that they are simply not in a position to perform the role of external valuer due to not being able to demonstrate knowledge and understanding of an AIF's investment strategy as required by Article 73(2)(c) of the AIFMD Level 2 Regulation. Surveyors perform valuations by reference to the nature, location, condition and utilisation of

buildings in accordance with professional standards issued by RICS and do not take account of factors specific to the owners of buildings, such as investment strategies.

- The unlimited liability of an external valuer to an AIFM created as a consequence of Article 19(10) of the AIFMD will increase significantly the professional liability risks faced by firms of surveyors and this will drive a dramatic increase in the cost of their professional indemnity insurance. Ultimately these additional costs will end up being borne by investors in the fund.

For investors there is no material benefit to be obtained from engaging an external valuer nor from voting in favour of changing the constitutional arrangements. Nevertheless, the costs involved for either approach are significant. We would be interested in the FCA's views on whether there is any flexibility for existing funds in this respect. Also, we request that the FCA recognises that there are many property fund managers who are required or expected by their investors to use valuations provided by independent surveyors, but in circumstances where those surveyors are currently refusing to be engaged as external valuers (due to a combination of the unlimited liability and the inability to comply with Article 73(2)(c)). This means that many managers are currently in an invidious position.

Verification of prices recommended by portfolio managers

We agree broadly with the safeguards provided under question 1.10, however it would be important and helpful to provide further clarification on what is regarded as sufficient in the context of the need to demonstrate *"reasonable efforts to independently verify the price recommended by the portfolio manager"* as required by the second bullet of the second paragraph under question 1.10. In this respect we note the FCA's expectations in respect of trustee and depositary oversight of property valuations as reported in the February 2015 fund authorisation and supervision update¹: *"This will include some form of check of valuations to ensure they are accurate (e.g. comparing valuations against a relevant benchmark or checking a sample of valuations)."* It would be helpful to clarify that it is sufficient for this purpose just to check that the price that has been recommended by the portfolio manager is the same price as that which was provided by the independent surveyor.

The reason this clarification is important is because valuation of real estate is generally extremely expensive, and it is important that in order to satisfy this reasonable efforts test independent members of an AIFM's valuation committee do not have to repeat all the material aspects of the process already undertaken by the independent surveyor. Unlike listed securities, real estate valuations cannot be cross-checked easily against multiple sources. In many property funds the investors expect that the AIFM uses the valuation provided by the independent firm of surveyors without making any changes to it. In summary, it would be helpful to clarify that "reasonable steps to verify" does not mean duplicating work already done by the external independent expert, or second guessing the basis for an independent expert's view, where the price recommended by the portfolio manager is in practice simply the valuation provided by the independent expert firm of surveyors (whose valuations the investors expect the AIFM to follow). In a real estate context, although the surveyor in nearly all cases is strictly a "valuation adviser" investors still expect AIFMs to use the independent surveyor's value (absent exceptional circumstances) and it is vital there is no suggestion that the independent members of a valuation committee must themselves carry out the sorts of checks referred to in Article 71(3) of the AIFMD Level 2 Regulation.

¹ <http://www.fca.org.uk/firms/firm-types/fund-authorisation-and-supervision/fund-supervision/fund-authorisation-supervision-update>

Valuation committee independence

Linked to the above point, we are concerned about managers', particularly smaller managers', ability to engage and retain sufficiently senior and competent staff to serve on a valuation committee without compromising the functional independence of those staff through their compensation arrangements. Part of the solution may be to engage non-executives but whether this is viable depends on the extent to which a valuation committee is required to independently verify the price recommended by a valuation adviser or a portfolio manager. In any case such an approach will incur significant additional cost (for no benefit, since investors want the valuations provided by the independent surveyor to be used).

Valuation advisers

As indicated above, we agree with the clarification that the valuer can take advice from other contributors, such as price providers and valuation advisers, and note that it seems evident from the first paragraph under question 1.9 that this is intended to deal with third-party contributors. However, we think the final sentence of paragraph (2) could cause confusion by creating a perceived link to the safeguards in question 1.10. It would be clearer if valuation advisers were defined as "...third-party expert providers of bespoke valuation services" in the same way as pricing providers are referred to as third-parties. It would then be clear that question 1.9 deals exclusively with third-party contributors and question 1.10 deals only with related parties that give advice where additional safeguards are required to ensure impartiality. It would then be possible to delete the potentially confusing final sentence.

Boards of directors

We welcome the carve-out ensuring that boards of directors and trustees are not regarded as undertaking the valuation function. However, this carve-out is framed too narrowly to reflect the full diversity of legal forms and governance structures employed by AIFs. For example, it is common for AIFs to be Limited Partnerships which have General Partners and Operators. In order to ensure even treatment of different legal forms and governance arrangements, the carve-out should be extended to all governance bodies, aside from the AIFM itself.

Next steps

AREF and RICS would welcome a meeting with FCA to discuss this issue further, and to ensure FCA is fully aware of the manner in which this sector of the industry operates before any final guidance is issued.

Yours sincerely



Mark Sherwin
Secretary General