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Regulator puts Reits into turmoil

By Steve Johnson

The $825bn real estate investment trust industry could be thrown into turmoil by a controversial decision by BaFin, the German financial regulator.

BaFin has proposed that German Reits should be regulated as investment funds under the EU's Alternative Investment Fund Managers Directive, due to come into effect in July.

Real estate investment trusts

This would bar many equity funds from investing in Reits, unless they are created as "funds of funds". It would deter investment from countries such as China, which restricts holdings of foreign funds.

It would raise costs by subjecting Reits to derivatives clearing, margining and depository requirements. It would also force Reits to pay Europe's mooted financial transaction tax and compel senior executives to abide by proposed restrictions on remuneration.

Fair Value Reit, a small German vehicle, estimated that the cost of a depository alone would be about €400,000 a year, a third of its likely surplus.

Gareth Lewis, director of the European Public Real Estate Association, said the trade body was "alarmed" by BaFin's proposals, which it feared could be adopted by a number of other European regulators.

"It should not be underestimated how influential this could be on the approaches taken across other European countries," said Mr Lewis. "Although Germany has a small listed property sector, it will be an influential voice in the interpretation of the AIFMD."

In a letter to BaFin, the National Association of Real Estate Investment Trusts, the US trade body, said its members would face "an uncertain regulatory landscape in Europe, unsure of whether they were obliged to comply not only with the AIFMD but also with other pieces of EU financial services legislation that apply to AIFs".

Nareit's concerns revolve around whether BaFin would insist on all Reits that accept investment from German investors or own German property having to comply with the AIFMD. It even raised the possibility that fund of fund rules would apply if a German investor bought into the S&P 500 stock index, which includes 16 Reits.

Tony Edwards, Nareit's general counsel, said in his letter to BaFin that classifying a Reit as a fund on the basis that it has a defined investment policy would be equivalent to Germany classifying US bank holding companies as funds.

BaFin declined to comment.

Under the AIFMD, an alternative investment fund is defined as any non-Ucits collective investment undertaking "which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy". It is designed primarily to cover private equity and hedge funds, as well as more traditional real estate funds.

But the industry argues Reits are operating companies with a "business strategy", rather than a defined and fixed investment policy, because they are free to switch focus, for instance from shopping centres to offices, as they see fit.

However, while some traditional property funds may have a remit to invest in a particular market niche, many others are also free to switch opportunistically between sub-sectors.

Despite this, Mr Lewis argued that German Reits "are essentially the same as other German corporate businesses".

Angela Haupt, managing director of MRAG, a Berlin-based investment and advisory firm, feared the move would drive many investors away from Reits.