



Investment & Financial Services Association Ltd

**Response to ASIC Consultation Paper 100  
Unlisted Property Schemes – improving disclosure for retail investors**

Dated: 11 August 2008

## INTRODUCTION

The response of IFSA members to Consultation Paper 100 and the draft Regulatory Guide was generally supportive. The principles as a whole reflect the approach to current PDS disclosure. There are, however, issues of detail that are identified in the following responses to matters raised.

The regulation and disclosure of unlisted property trusts has been the subject of specific focus and the imposition of additional regulatory requirements in the past. By way of background, prior to the Managed Investments Act, unlisted property trusts were subject to specific regulations which resulted from the Estate Mortgage collapse and systemic concerns with property valuations, fund liquidity and the cyclical nature of markets generally. With the passage of the Managed Investments Act, Part 5C.6 of the Corporations Act 2001 (**Act**) effectively replaced the prescribed covenants that were previously required to be included in trust deeds of property funds offered to the public.

The requirements of Part 5C, in particular sections 601FC(1)(i), (j) and (k) and members withdrawal rights under Part 5C.6 of the Act, underpin the compliance plan arrangements for unlisted property funds which together with the general disclosure obligation under section 1013E of the Act ensure that the principles outlined in the CP are generally addressed in the PDS for an unlisted property scheme.

It is difficult to comment with any degree of certainty on the value-add to a retail client that the additional disclosures (excluding an update on market conditions and performance) will make. There is, in our view, a direct link here to the issue of financial literacy more broadly - anecdotal evidence from the Government's financial literacy body would suggest that disclosure of, for example, in-depth gearing ratio information would not be understood by the majority of investors.

### *Timeframe*

Timeframe for implementation - the timing for implementation may be unachievable. Fund managers would need to embed new structures around the reporting content which generally takes some time to ensure that the data and information capture meets the requirements of the guidance, as well as testing systems to ensure that data integrity is absolute. This requires lead time.

Instead, we would recommend that the changes become effective from no later than 01 July 2009 (to coincide with a new financial year), but promote early adoption.

One other issue to consider from a PDS development perspective - if any fund management entity is in a product development cycle when this is introduced, and assuming that the timeline is not changed, there is a real possibility that substantive costs may be incurred if a PDS needs to be re-worked to capture these additional requirements

## RESPONSE TO SPECIFIC QUESTIONS

### The disclosure principles

Question B3Q1: Do you agree with the proposed definition of 'unlisted property scheme'?

Agree

Question B3Q2: Are there any other schemes to which the guide should apply?

Principles 4 – 8 are generally applicable to the majority of managed investment schemes and are currently reflected in PDS disclosures. Where an unlisted property scheme, as defined at B1, has no borrowings and hence no gearing or interest cover the first three principles will be inapplicable.

Question B4Q1: Have we identified the relevant disclosure principles? What is missing and/or is anything not relevant?

The danger in seeking to exhaustively list critical investor focussed disclosure principles/requirements is that it might be taken to qualify the general and other specific disclosure obligations under the law. The principles listed do, in our view, cover the features that are relevant to the operation of the scheme and a potential investors. The extent to which disclosures on gearing ratio, interest cover and scheme borrowing are understood, or of immediate interest to investors, is however debateable.

Question B4Q2: Are there any types of unlisted property schemes for which some or all of the disclosure principles are inappropriate?

Clearly, where an unlisted property scheme, as defined at B1, has no borrowings and hence no gearing or interest cover the first three principles will be inapplicable where it is not intended that the scheme has any borrowings.

This may be the case where the unlisted property trust scheme, as defined at B1, invests in other unlisted property trust schemes.

### **Gearing Ratio (000.38), Interest cover (000.44) and scheme borrowing (000.47)**

Each of the details to be provided in relation to gearing ratio (000.38), interest cover (000.44) and scheme borrowing (000.47) are overly prescriptive and will require considerable explanation to be meaningful to clients. Additionally the inclusion of such detail does not sit well with the general overriding principle that the PDS must be clear concise and effective.

Draft 000.47, in particular, is problematic in that it requires considerable additional disclosures in the PDS. Additionally, the information ((a) to (c)) would become very quickly out of date requiring constant issue of supplemental PDSs.

## **Gearing ratio**

Question B4Q3: Have you any comments on the formula we propose to adopt for calculating gearing ratio? Is there an alternative formula that would be preferable?

The prescribed formula: *Gearing ratio = total liabilities / total assets*, will lead to responsible entities declaring a perceived gearing situation where one does not exist. Total liabilities necessarily include accrued fees and short term withdrawal funding and would, therefore, force responsible entities to declare a false gearing situation.

We believe the formula should be amended to reflect interest bearing liabilities or investment related debt. The gearing ratio typically pertains to debt not liability. It is suggested that the gearing ratio calculation is better calculated as:

$$\frac{\text{Debt}}{\text{Total assets}} \quad \text{or} \quad \frac{\text{Debt}}{\text{Property assets}}$$

This will reflect the general industry use of such a calculation. It would also be useful to have a day 1 calculation and an annual forecast to assist with decision making.

Question B4Q4: Because of the relatively small proportion of development assets in the unlisted property scheme sector we have not included a separate ratio, such as a loan to cost ratio that accommodates development assets? Would this result in too much information for retail investors (given that some schemes would need to disclose both a gearing ratio and a loan cost ratio)?

A separate ratio should not be included. This is information that adds a small amount of information in the overall investment decision, and its inclusion will only confuse investors.

## **Interest cover**

Question B4Q5: Have you any comments on the formula we propose to adopt for calculating interest cover? Is there an alternative formula that would be preferable?

The interest cover calculation should not apply to development funds (i.e. funds that buy land, construct roads and sell lots). To apply in this scenario it would make little sense.

Question B4Q6: Would it be useful for retail investors to have information on a scheme's debt service cover ratio? This ratio measures the amount of cash flow available to meet annual interest and principal payments on debt.

Agree. It would be useful to have the debt service cover ratio as this demonstrates the cash cover in the transaction.

### **Scheme borrowing**

Question B4Q7: Do the proposed 12-month increments provide an appropriate level of disclosure? Can you suggest an alternative?

The information would not in our view provide useful information to investors.

Question B4Q8: Our disclosure principle on scheme borrowing does not specify that responsible entities should disclose probable or likely breaches of loan covenants. Would information on these prospective breaches be helpful for retail investors? Would providing the information be practical for responsible entities?

The information would not in our view provide useful information to investors.

### **Portfolio diversification**

Question B4Q9: Will all the matters dealt with under this disclosure principle assist retail investors? Are there any other matters that should be covered?

See comments in Part C of this document on RG 000.54 to 000.58.

### **Distribution practices**

Question B410: Is it feasible to disclose whether distributions sourced other than from realised income are sustainable?

No comment

### **Upfront disclosure**

Question C1Q1: Are there practical problems with expecting this disclosure in PDSs? If so, what alternative would ensure investors are adequately informed?

It may be difficult to put the information upfront. Such information would generally appear at different places in the PDS. Much of the disclosure could be better placed in fact sheets, accessible from the issuer website, which is regularly updated.

Question C1Q2: Do you agree with our approach to the operation of the disclosure requirements?

The information required by this regulatory Guide is subject to constant change, and even taking into account only material changes, would still require a PDS to be issued more often than would be considered reasonable. We believe that an appropriate alternative would be to allow information to be disclosed and updated on the issuer website – the current CO 03/237 is too narrow to allow this type of information to be updated via a website.

### **When you need to apply the disclosure principles**

Question C4Q1: Do you agree with the proposed timetable for implementing of the disclosure principles for unlisted property schemes?

Timeframe for implementation may be difficult to achieve and would certainly result in significant additional costs to industry if the implementation date was to be maintained. The preferred proposal for existing funds would be from 1 July 2009.

### **Not an 'if not, why not' approach**

Question C5Q1: Do you think an 'if not, why not' approach to disclosure against benchmarks would produce a better outcome for retail investors in unlisted property schemes?

The "if not why not approach" should not be adopted for retail investors in unlisted property schemes.

Question C5Q2: Do you think disclosing the information required in the disclosure principles would be easier for responsible entities if done on an 'if not, why not' basis?

No comment

Question C5Q3: If we required responsible entities of unlisted property schemes to disclose against benchmarks on an 'if not, why not' basis, what benchmarks should we develop for the matters covered by the key disclosure principles? In particular, are there numerical benchmarks that would be suitable for gearing and interest cover benchmarks?

No comment

### **Advertising and unlisted property schemes**

Question C6Q1: Are there any specific problems with advertising schemes that should give guidance on?

No comment

### **Compliance plans, compliance committees and compliance plan auditors**

Question D2Q1: Will compliance plans need to be modified to specifically address the disclosure principles and advertising obligations, or are existing compliance plans generally satisfactory to address these?

Existing compliance plans are required to satisfy the requirements of the Act and the scheme constitution (section 601HA ). There should not be any need to amend compliance plans to reflect the principles outlined in the Consultation Paper. It may be that responsible entities review procedures manuals and check list underpinning

compliance plan arrangements to confirm that the principles are adequately addressed but this should not require amendment to compliance plans.

Question D2Q2: Are there any practical problems with the proposed role for compliance committees and compliance plan auditors? If so, what would ensure investors are adequately protected?

There should be no change to the existing role of compliance committees and compliance plan auditors – compliance plan arrangements are monitored, tested and audited for compliance with the Act and scheme constitution. It is a dynamic operation and intended to be adaptable and responsive to different business and economic circumstances resulting in appropriate action. The compliance committee reports to the Board on compliance with the Act and scheme constitution.

Question D2Q3: What impact would our proposals have on costs for compliance committees and compliance plan auditor, and how might this affect responsible entities and investors? Please give details

To the extent that the proposals result in additional disclosure and monitoring it will result in further costs to the scheme.

### **Investment ratings**

Question E1Q1: Are investment ratings useful to retail investors in property schemes? Are investment ratings being properly explained to retail investors?

Investment ratings are useful and should be explained clearly in disclosure documents. Differences in approach by firm's / companies means that the criteria for such ratings should be disclosed due to the different "labelling" of terms.

Question E1Q2: What are the advantages (for issuers, advisers, distribution channels, and retail investors) of the use of investment ratings and research houses for property schemes?

Investment ratings and research houses provide an independent view of the transaction and benchmarking.

Question E1Q3: What difficulties (if any) do retail investors face in interpreting investments ratings for property schemes?

As per the above, terms used differ between firm's / companies and could be a cause for confusion. Key disclosure of terms is the key.

Question E1Q4: How comparable are investment ratings for property schemes that are prepared by different research houses?

The definition of the ratings is required to be clear to enable comparison. However, differences in investment ratings can, we believe, be useful in highlighting different methodologies for the evaluation of investment products. A rating provides an assessment based on certain premises and should not be taken as an absolute truth.

Question E1Q5: Is there a risk that retail investors may place undue weight on an investment rating when making their investment decision?

Yes. Education is the key to address this issue.

Question E1Q6: Where an unlisted property scheme advertises a rate of return, is there a risk that retail investors may consider an investment rating for the scheme to be a credit rating?

Yes. Education is the key to address this issue.

Question E1Q7: Are the requirements about the use of investment ratings in advertisements appropriate? Should we impose any other conditions on the use of investment ratings for property schemes (e.g. prohibiting the use of investment ratings in advertisements or requiring warnings to accompany investment ratings)?

Clear definition of what the ratings represent is important.

**PART C. COMMENTS ON DRAFT REGULATORY GUIDE 000**

Reference No.	Requirement	Comment
000.2	Scope of application of Guide	Suggest that all words after “schemes” be deleted. IDPS arrangements are regulated as financial services and investors have a beneficial interest in their actual asset selection with the ability to have that asset transferred to them or cash in lieu of the asset paid to them.
000.12	On going disclosure	Updating information referred to in the disclosure principles should only be necessary where there is a material change in the information. The 6 month requirement is arbitrary and may result in unnecessary costs being incurred.
00014	Liability for material non-disclosure	Failure to apply the principles will only result in liability to investors under the Corporations Act where a person suffers loss or damage as a result of the non-disclosure and the PDS is defective as a consequence of that non-disclosure.
000.16 – 000.18	Compliance plans	Is it the intention of ASIC to issue a direction to responsible entities under section 601HE(2)
000.24	Investment in real property	Para(a) should be to invest a substantial proportion of its cash assets in real property or unlisted property schemes or to “purchase real property assets or interests in other unlisted property schemes”.
000.36	Responsible entities should disclose a gearing ratio for the scheme calculated using the following formula: <i>Gearing ratio = total liabilities / total assets</i>	We believe the prescribed formula will lead to responsible entities declaring a perceived gearing situation where one does not exist. Total liabilities necessarily include accrued fees and short term withdrawal funding and would, therefore, force responsible entities to declare a false gearing situation.  We believe the formula should be amended to reflect interest bearing liabilities or investment related debt.
000.54(a)	Disclosure by geographic location	Please provide a definition for geographic location – whether by state, city or as defined by an external party such as Standard & Poor’s

000.54(c)	RE should disclose the current composition of the scheme's investment portfolio including: for each significant property, the most recent valuation, and where applicable, the capitalisation rate, discount rate, and terminal capitalisation rate (or yield) adopted in the valuation.	<ul style="list-style-type: none"> <li>• Please define the term 'significant' in relation to its use as a measure of both property(ies) and tenant(s) within the Regulatory Guide.</li> <li>• Please define the calculation methodology you expect to be used for disclosures of rates/yields etc in this section of the Regulatory Guide. Standard calculations will assist in providing consistent disclosure across the industry.</li> <li>• We believe the required disclosure of these details, in conjunction with those required by 54(f) may lead to disclosure of potentially confidential or market sensitive issues.</li> </ul>
000.54(f)	For each significant tenant, the name of the tenant, the area occupied by the tenant as a percentage of the total lettable area of the property portfolio and the lease expiry of that tenant.	<ul style="list-style-type: none"> <li>• In addition to the request for definition of the term 'significant' as it relates to this point, please also provide clarity for the term 'tenant'.</li> </ul> <p>Does the term 'tenant' refer to:</p> <ul style="list-style-type: none"> <li>- the holding company or listed entity whose related (or sub) entities may occupy several tenancies within one or more properties in the scheme, or</li> <li>- each single tenant, regardless of their company structure, ie whether they are related entities.</li> </ul> <p>(for example only: Company XYZ owns Brand A, Brand B and Brand C, all of whom have tenancies in the scheme property. Would they be considered one tenant (Company XYZ), or four single tenants?</p> <ul style="list-style-type: none"> <li>• As referenced in 54(c), disclosure of these requirements, may lead to disclosure of price sensitive information and place disclosing Trusts at a disadvantage relative to other structures.</li> </ul>
000.56(c)	Schemes involved with property developments should also disclose pre-sale and lease pre-commitments where applicable.	We believe that if disclosure of names of pre-sales and pre-commitments is required for the purposes of this section it may lead to confidentiality issues for the scheme RE.

000.62(a)	Valuers who accept an appointment to provide valuations for an unlisted property scheme should be registered under one of the state or territory valuer registration regimes.	This requirement does not appear to make provision for valuers who operate outside of the Australian states and territories. This issue will need to be addressed for schemes which hold property located outside of Australia.
000.62(b)	Valuers who accept an appointment to provide valuations for an unlisted property scheme should include a statement in their valuation reports on whether the valuation complies with all relevant industry standards.	This requirement does not appear to make provision for valuers who operate outside of Australia. We believe this section needs to consider whether valuers who operate internationally will be required to comply with relevant Australian industry standards or those of the country they are registered in?
000.66	Related Parties	Where a related party owns units in an unlisted property scheme on the same terms and conditions as other investors in the scheme we believe they should be excluded from disclosure requirements in relation to related parties.
000.68	Where a scheme has made or forecasts to make distributions to members, the RE should disclose: a) sources for distributions b) whether the source of any forecast distributions is expected to differ from the sources of previous distributions c) if distributions are not solely sourced from realised income, the reasons for making distributions from other sources; and d) whether distributions sourced other than from realised income are sustainable.	We believe this requirement should be limited to schemes who forecast a particular rate of distribution.  Please clarify whether you consider schemes who simply say they will make (or generally make) a distribution without specifying a given rate will be required to comply with these disclosure provisions.
000.83(b)	The PDS for an unlisted property scheme should clearly explain the track record and experience of senior management.	Please clarify :  <ul style="list-style-type: none"> <li>• Whether 'senior management' refers to personnel within the scheme manager or the scheme RE.</li> <li>• The level and type of detail expected for disclosure in relation to 'track record' and 'experience'.</li> </ul>

