ASIC
Australian Securities & Investments Commission

REPORT 280

Response to submissions on CP 163 Unlisted property schemes: Update to RG 46

March 2012

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 163 *Unlisted property schemes: Update to RG 46* (CP 163) and details our response to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

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- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
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Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 46 *Unlisted property schemes: Improving disclosure for retail investors* (RG 46).

Contents

A Overview/Consultation process

About our consultation

1 In Consultation Paper 163 *Unlisted property schemes: Update to RG 46* (CP 163), we consulted on proposals to address a number of key disclosure issues identified during a detailed review of disclosure documents issued by responsible entities in the retail unlisted property sector.

2 Generally, we consulted on the introduction of benchmarks, and clarified our position on a number of the existing disclosure principles. The proposals sought to improve the comparability and consistency of disclosure, and to amend or clarify a number of the disclosure principles in RG 46 to improve disclosure to retail investors.

3 This report highlights the key issues that arose out of the submissions received to CP 163 and our responses to those issues. This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 163. We have limited this report to the key issues.

Responses to consultation

4 We received 11 responses to CP 163 from a number of different sources, including an adviser firm on behalf of retail investors, a standards organisation, accountants and auditors, peak bodies representing investors, and responsible entities. We are grateful to respondents for taking the time to send us their comments.

5 For a list of the non-confidential respondents to CP 163, see the appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 163.

6 The main issues raised by respondents related to:

(a) the timing of implementation;

(b) for the gearing ratio and the interest cover ratio, reference to individual assets;

(c) distributions and the definition of realised income;

(d) what is considered a development and/or construction scheme; and

(e) the need for further guidance on clear, concise and effective disclosure.

7 In updating RG 46, we have taken into account the key issues raised in the written submissions and also during industry consultation.

B Proposed benchmarks for unlisted property schemes

Key points

In CP 163, we proposed that responsible entities of unlisted property schemes should disclose against certain key benchmarks and provide information about these benchmarks on an 'if not, why not' basis in their Product Disclosure Statements (PDSs) and ongoing disclosure to retail investors from 1 July 2012.

This section summarises the feedback we received in response to the proposed benchmarks in CP 163.

The proposed benchmarks

8 In CP 163, we proposed that responsible entities should address the following six benchmarks on an 'if not, why not' basis:

(a) Benchmark 1: Gearing policy;

(b) Benchmark 2: Interest cover policy;

(c) Benchmark 3: Interest capitalisation;

(d) Benchmark 4: Valuation policy;

(e) Benchmark 5: Related party transactions; and

(f) Benchmark 6: Distribution practices.

9 Generally, respondents found our proposed benchmarks to be relevant, with two respondents suggesting two additional benchmarks.

10 One suggestion was to consider making the weighted average lease expiry (WALE) a benchmark. The respondent stated that property investment is focused on income and WALE is an important factor. They stated that WALE is complementary to the gearing ratio and interest cover ratio, and further suggested that adjusted net operating income (NOI) be disclosed at the same frequency as the scheme's distributions are paid.

11 The second suggestion was to add net tangible assets (NTA) as a benchmark for closed-end schemes. The respondent thought responsible entities should disclose initial NTA at the front of a PDS, and ongoing NTA at least every six months, because the starting NTA has an impact on the overall return to investors and is as important as the first-year yield. This suggestion was supported by another respondent, but the respondent stated this was only of value if valuation and liability statements (gearing/debt ratios) are up-to-date.

12 We conducted further consultation with industry and industry associations on this point and received a number of submissions. Submissions strongly supported the proposal to include a disclosure principle or a benchmark disclosing the NTA backing per unit of their investment in the scheme.

13 One respondent observed that investor education is important and investors should engage with professional advisers and take responsibility for their investment choices.

14 Another respondent stated that they agreed with the logic of adopting effective ways of communicating the risks faced by retail investors, particularly for debt versus the value of the assets within a scheme. They went on to state that this information will be of benefit to retail investors in their risk assessment.

15 One respondent stated that they believe prescribed disclosure standards are contrary to the *Corporations Act 2001* (Corporations Act), which does not adopt a checklist approach. They stated that the adoption of a prescribed benchmark approach implies non-compliance is a negative thing, and these new obligations will lengthen the disclosure generally, which is at odds with our push for shorter PDSs. They went on to state that the relevant information is already disclosed in a PDS.

16 Three respondents stated the proposals would result in additional costs that would be material, particularly resources required and costs incurred to appropriately manage and monitor, verify and report on the proposed information. One of these respondents stated that, unfortunately, if disclosure is to be heightened, it may bring with it additional costs.

ASIC's response

We agree that WALE is an important factor for retail investors to consider when making a decision about investing in unlisted property schemes, and we already ask responsible entities to disclose this information in Disclosure Principle 4: see updated RG 46 at RG 46.87–RG 46.97. Therefore, we do not consider it necessary to include this information in a benchmark.

Even though we consider NOI to be another factor that may help investors generally, we note this information, if needed by an investor or their adviser, can be derived from the scheme accounts. We did not receive broad submissions on this point and did not consult on NOI in CP 163, although we may consider this factor in the future.

We agree that disclosure of NTA on a per-unit basis is important information for retail investors, and consulted further with industry on this point. Based on the positive feedback received during this further consultation, disclosure of NTA backing on a per-unit basis has been included in a new disclosure principle for net tangible assets: see paragraphs 98–99 of this report.

Benchmark 1: Gearing policy

17 In CP 163, we proposed that, in addition to providing the information already outlined under Disclosure Principle 1 of RG 46, a responsible entity should disclose on an 'if not, why not' basis whether it maintains and applies a written policy that governs the level of gearing at an individual asset level.

18 We proposed that, if a responsible entity discloses against this benchmark, it should disclose its gearing policy and whether or not the scheme currently complies with this policy.

19 Two respondents, although agreeing the benchmark has some relevance, stated that the benchmark did not contemplate circumstances where multiple properties are cross-collateralised within one scheme. They went on to state that cross-collateralisation does not translate to gearing levels at an individual asset level. One of the two respondents then stated that it may be more beneficial to disclose the gearing ratio and interest cover ratio for each credit facility, rather than for each individual asset, as this is more relevant for investors.

20 Another respondent suggested that the gearing policy be set at the scheme level and the loan-to-valuation ratio should be disclosed at the individual asset level.

21 One respondent's view was that the proposal would be difficult to implement where the scheme's direct property exposure is via investment in another direct property scheme with asset co-ownership structures where the gearing is not determined by the responsible entity.

22 Another respondent considered that the risk associated with the levels of gearing of the scheme and the implications of the gearing, particularly if there is more than one credit facility in the scheme, should be highlighted for investors.

23 One respondent suggested that the use of the word 'governs' should be reconsidered as the level of gearing may be driven by market forces rather than policy and that any policy should set a framework for the monitoring and management of gearing within a scheme.

24 One respondent observed that for the majority of non-development schemes, gearing on an individual asset level would not apply.

25 Although one respondent considered gearing to be a key risk, they did not believe that reporting against measures on an individual asset level best served investors' needs. As stated in other submissions, most of the schemes with multiple assets have financing arrangements secured across the portfolio. The loan covenants are based on total portfolio assets, not individual assets.

ASIC's response

After considering the submissions made by various respondents, we agree that the benchmark should refer to each individual credit facility, rather than each individual asset within a scheme.

We have amended this benchmark to state: 'The responsible entity maintains and complies with a written policy that governs the level of gearing at an individual credit facility level.'

See updated RG 46 at RG 46.31–RG 46.35.

Benchmark 2: Interest cover policy

26 In CP 163, we proposed that, in addition to providing the information already outlined under Disclosure Principle 2 of RG 46, a responsible entity should disclose on an 'if not, why not' basis whether it maintains and applies a written policy that governs the level of interest cover at an individual asset level.

27 We proposed that, if a responsible entity discloses against this benchmark, it should disclose its interest cover policy and whether or not the scheme currently complies with this policy.

28 Most of the respondents stated that calculating the interest cover ratio at an individual asset level, particularly when there was some form of cross-collateralisation, was not possible and was impractical.

29 One respondent observed it would not promote clear, concise and effective disclosure, and that the level of interest cover would not necessarily be governed by policy; it may be driven by other factors.

30 One respondent specifically stated that 'individual asset level' should be replaced with 'properties attributed to a funding arrangement'. They went on to state that the interest cover ratio should be calculated at the facility level, regardless of the number of assets within a scheme. They recommended the responsible entity should disclose that the interest cover ratio has been calculated in accordance with the credit facility. This was also suggested by other respondents with the view that disclosure should be based on the relevant financier's exposure.

ASIC's response

After considering the submissions made by various respondents, we agree that the benchmark should refer to each individual credit facility, rather than each individual asset within a scheme.

We have amended this benchmark to state: 'The responsible entity maintains and complies with a written policy that governs the level of interest cover at an individual credit facility level.'

See updated RG 46 at RG 46.36–RG 46.40.

Benchmark 3: Interest capitalisation

31 In CP 163, we proposed that, in addition to providing the information already outlined under Disclosure Principle 2 of RG 46, a responsible entity should disclose on an 'if not, why not' basis whether the interest expense of the scheme is not capitalised.

32 If a responsible entity meets this benchmark, it would disclose that the interest expense of the scheme is not capitalised.

33 All of the respondents except one agreed with the proposal. One respondent considered the benchmark to be irrelevant.

34 Most respondents stated that interest would not be capitalised unless the scheme was a development scheme, and that benchmark disclosure by exception to the benchmark would be appropriate.

ASIC's response

While a number of respondents considered the proposed benchmark should be applied by exception, we believe this benchmark can be easily answered by responsible entities.

If the responsible entity does not capitalise the interest of the particular scheme, then the disclosure would state that it meets this benchmark.

See updated RG 46 at RG 46.41–RG 46.44.

Benchmark 4: Valuation policy

35 In CP 163, we proposed to remove existing RG 46.68 and RG 46.71 under Disclosure Principle 5 and incorporate the remaining information from this principle into a benchmark.

36 Under the proposed benchmark, in addition to providing the remaining information from Disclosure Principle 5, a responsible entity should disclose on an 'if not, why not' basis if it maintains and applies a written valuation policy that includes the following features:

(a) a valuer who:

  (i) is registered or licensed in the relevant state, territory or overseas jurisdiction in which the property is located;

  (ii) subscribes to a relevant industry code of conduct in the jurisdiction in which the property is located; and

  (iii) is independent;

(b) procedures to be followed for dealing with any conflicts of interest;

(c) rotation and diversity of valuers; and

(d) for each property, an independent valuation to be obtained:

(i) before the property is purchased:

(A) for a development property, on an 'as is' and 'as if complete' basis; and

(B) for all other property, on an 'as is' basis; and

(ii) within two months after the directors form a view that there is likelihood that a decrease in value of the security property may have caused a material breach of a loan covenant.

37 We proposed that a responsible entity that discloses against this benchmark should disclose its valuation policy and whether the scheme currently complies with this policy.

38 About half of the respondents agreed with this proposal, except for the following:

(a) that the valuer be registered in the state or territory where the property is located;

(b) the timing of valuations; and

(c) that an independent valuation should be obtained for a likely increase in value as well as a decrease.

39 Two respondents considered the benchmark would impose significant costs on the schemes for little or no real benefit.

40 One respondent stated that not all states and territories have a registration or licensing regime in place. They suggested that valuers who accept an appointment to provide valuations for an unlisted property scheme should be members of the Australian Property Institute and hold a certification of Certified Practising Valuer (CPV) with a minimum of five years' experience as a CPV in valuing property similar to the property in question.

ASIC's response

After considering the different submissions, we have amended this benchmark to state that 'the responsible entity maintains and complies with a written valuation policy that requires a valuer to be registered or licensed in the relevant state, territory or overseas jurisdiction in which the property is located (where a registration or licensing regime exists), or otherwise be a member of an appropriate professional body in that jurisdiction.'

We have also amended the benchmark to state that a valuation is to be obtained 'within two months after the directors form a view that there is a likelihood that there has been a material change in the value of the property.'

We have included further guidance on the timing of valuations.

Benchmark 4: Valuation policy replaces Disclosure Principle 5: Valuation policy: see updated RG 46 at RG 46.45–RG 46.52.

In relation to concerns about the cost of additional valuations, these costs will be of more significance in a downward market phase. We consider these costs would be outweighed by the benefits to members from increased clarity about the value of the scheme's assets.

We acknowledge that the issue of a decline in the value of security property applies to other products and will consider whether to extend this benchmark to other products in future.

Benchmark 5: Related party transactions

41 In CP 163, we proposed that, in addition to providing the information already outlined under Disclosure Principle 6 of RG 46, a responsible entity should disclose on an 'if not, why not' basis that it maintains and applies written policies on related party transactions, including the assessment and approval process for such transactions and arrangements to manage conflicts of interest.

42 We stated that if the responsible entity discloses against this benchmark, it should provide disclosure about its related party policy and state whether or not the scheme currently complies with this policy.

43 All respondents agreed with this proposal, although one respondent noted that under a 'responsible entity for hire' arrangement, the related party policy of the scheme manager rather than the responsible entity may be more relevant. It was also the view of one respondent that in light of existing related party policy and conflicts management obligations, this benchmark is additional and is not necessary.

44 Another respondent who agreed with the proposal stated that this benchmark would serve to create transparency in any related party transactions so that they are brought to the attention of the retail investor.

ASIC's response

While we note the concern by one respondent about additional obligations, we have drafted this benchmark to be consistent with Regulatory Guide 76 *Related party transactions* (RG 76) so that it does not place further obligations on responsible entities for related party disclosures.

We have included this benchmark as proposed in CP 163: see updated RG 46 at RG 46.53–RG 46.56.

Benchmark 6: Distribution practices

45 In CP 163, we proposed that, in addition to providing the information already outlined under Disclosure Principle 7 of RG 46, a responsible entity should disclose on an 'if not, why not' basis that the scheme will only pay distributions from the realised income of the scheme. If a responsible entity discloses against this benchmark, it should disclose that the scheme will only pay distributions from realised income of the scheme.

46 A few respondents made the point that the term 'realised income' was not clear. Some respondents stated that, in some instances, not paying distributions from realised income is a timing issue and while it is generally the intent of the responsible entity to distribute based on realised income, there is a timing mismatch.

47 A suggestion was made by two respondents to replace 'realised income' with 'cash from operations available for distribution' because this is a better measure of cash available for distribution.

48 Another respondent, who agreed with our proposal, stated that if distributions are paid from borrowings, this has the propensity to distort the risk profile of the scheme in the eyes of the retail investor.

ASIC's response

After considering the submissions, we have amended this benchmark to state: 'The scheme will only pay distributions from its cash from operations (excluding borrowings) available for distribution.'

See updated RG 46 at RG 46.57–RG 46.61.

Up-front disclosure

49 In CP 163, we proposed that the PDS should address each of the benchmarks on an 'if not, why not' basis. The responsible entity should state if it meets the benchmark and, if it does not meet the benchmark, explain how it deals with the underlying concern in another way.

50 Generally, all respondents agreed with this proposal.

ASIC's response

We expect responsible entities to address each of the benchmarks on an 'if not, why not' basis': see updated RG 46 at RG 46.28–RG 46.30 and RG 46.121–RG 46.139.

Ongoing disclosure

51 In CP 163, we proposed that if there is a material change to the information a responsible entity has disclosed against a benchmark, the responsible entity should notify investors of these changes in ongoing disclosure.

52 We suggested that responsible entities should also consider whether it would help investors to give them regular updates of the benchmark information. We suggested a responsible entity should update this information at least every six months.

53 Overall, respondents felt six-monthly updates were adequate. A few respondents believed this was too frequent and found it more feasible for a responsible entity to communicate on a six-monthly to 12-monthly basis via its website.

54 Other respondents stated the minimum reporting period should be quarterly, bringing the unlisted sector in line with the listed sector. These respondents also noted that the current continuous disclosure obligation process was unsatisfactory, with disclosure not being freely available on websites. They suggested disclosure should be available electronically for at least seven years.

55 One respondent's view was that responsible entities are already required under the PDS requirements to ensure material is up-to-date. They felt the imposition of additional disclosure to be unnecessary.

ASIC's response

While we received some differing views on our proposal for ongoing disclosure, the majority of respondents considered six-monthly updates were adequate.

We expect responsible entities to update the benchmark information at least every six months: see updated RG 46 at RG 46.140–RG 46.155.

Timing for implementing disclosure against the benchmarks

56 In CP 163, we suggested 1 July 2012 as the commencement date for responsible entities to disclose against the benchmarks.

57 Although most respondents agreed with the proposal and had no practical problems with the suggested date, one respondent stated that July 2012 was impractical in light of other proposed disclosure obligations from December 2011. They suggested July 2013 instead.

58 Another respondent believed an effective date of October 2012 was more appropriate because it would align with the annual reporting process and

allow responsible entities to use audited information, which is generally not available until the end of September.

ASIC's response

We considered all the responses on timing and found the reasoning behind the October 2012 submission to be sound, since investors should be provided with the most up-to-date information from audited accounts.

The commencement date for responsible entities to disclose against the benchmarks is 1 November 2012: see updated RG 46 at RG 46.119–RG 46.120.

C Proposed amendments to the disclosure principles

Key points

CP 163 contained proposals to update our guidance in RG 46 to clarify a number of issues and provide further guidance on our expectations for applying the disclosure principles. A draft update to our guidance on the disclosure principles in RG 46 was attached to CP 163.

We have updated RG 46 largely as proposed, with some minor amendments based on respondents' submissions.

This section summarises the feedback we received in response to CP 163 on our proposed changes to the disclosure principles.

The proposed amendments to the disclosure principles

59 CP 163 proposed amendments to the disclosure principles in RG 46 to clarify a number of issues and provide further guidance on our expectations for applying the disclosure principles.

Disclosure Principle 1: Gearing ratio

60 In CP 163, we proposed to clarify the following:

(a) where the gearing ratio and/or the 'look through' gearing ratio is not based on the latest financial statements, the source(s) and the date of the information should be disclosed;

(b) what these ratios mean should be explained in practical terms and the risks associated with the level of gearing in the scheme addressed; and

(c) if the gearing and/or 'look through' ratio is unable to be calculated, the reasons why not, the risks associated with the inability to calculate the ratios and the steps taken to address these risks should be disclosed.

61 Generally, respondents agreed with our proposal, with one respondent stating that the disclosure needs to be balanced with the clear, concise and effective requirements.

62 One respondent held the view that gearing, 'look through' gearing and interest cover ratios were only the first step. They stated that for each and every loan facility, the maturity date, interest rate, facility limits and undrawn amounts should also be disclosed. They noted that risks to investors can only be discovered if this level of detail is provided and a statement that a breach to a loan covenant has occurred provides very little information.

63 There was a suggestion that it would be more appropriate if the disclosure principle referred to the risks and impact of not knowing the gearing ratio, as opposed to the risks and impact of being unable to calculate the ratio.

> *ASIC's response*
>
> We agree that gearing, 'look through' gearing and interest cover ratios are only the first step when providing information to retail investors to enable them to make informed decisions about investing in unlisted property schemes. However, under Disclosure Principle 3: Scheme borrowing, responsible entities should already disclose information such as maturity dates, facility limits and undrawn or drawn amounts: see updated RG 46 at RG 46.78–RG 46.86.
>
> We have amended this disclosure principle as proposed in CP 163: see updated RG 46 at RG 46.62–RG 46.70.
>
> We also consulted on interest rates for each credit facility: see 'ASIC's response' under Disclosure Principle 3.

Disclosure Principle 2: Interest cover ratio

64 In CP 163, we proposed to clarify the following:

(a) where the interest cover ratio is not based on the latest financial statements, the source(s) and the date of the information should be disclosed;

(b) what this ratio means should be explained in practical terms, and the relationship between the income received by the scheme and the amounts required to be paid under the terms of any relevant finance facility should be addressed, as well as the ability of the scheme to meet its other financial obligations; and

(c) if the responsible entity is unable to calculate the interest cover ratio, it should disclose the reasons why not and explain the arrangements in place to meet payment obligations related to borrowed funds. The risks associated with these arrangements should also be disclosed.

65 Generally, all respondents agreed with our proposal.

> *ASIC's response*
>
> We have amended this disclosure principle as proposed in CP 163: see updated RG 46 at RG 46.71–RG 46.77.

Disclosure Principle 3: Scheme borrowing

66 In CP 163, we proposed that additional information about finance facilities should be disclosed, including:

(a) whether a scheme would be in breach of any covenants in any credit facility if either the operating cash flow or the value of the asset(s) used as security fall by 10% or more;

(b) for each credit facility:

(i) the aggregate undrawn amount;

(ii) the assets to which the facility relates;

(iii) the loan-to-valuation and interest cover covenants under the terms of the facility;

(iv) the interest rate of the facility; and

(v) whether the facility is hedged; and

(c) details of any terms in the facility that may be invoked as a result of investors exercising their rights under the constitution of the scheme.

67 Most of the respondents disagreed with this proposal. Many considered these details to be confidential between the scheme and the lender, and found the information to be too commercially sensitive for disclosure, and stated that disclosure would disadvantage the entity when seeking to refinance.

68 While disagreeing with the proposal, another respondent stated that most of the disclosure principle should be removed because it duplicates what is required under Australian Accounting Standard AASB 7 *Financial instruments: Disclosures*, where details are provided in the financial accounts of the scheme.

69 One respondent stated that this level of detail would over-complicate disclosure and suggested the disclosure principle should ask for 'details of any key terms within the facility'.

70 For disclosure if the value of the asset used as security for the facility were to fall by 10% or more, one respondent in particular found an arbitrary 10% figure to be not as relevant as disclosure of the actual buffer.

ASIC's response

We note that the proposed amendments to this disclosure principle caused respondents to consider the level of detail suggested was too commercially sensitive, and disclosure may disadvantage schemes when refinancing.

We have reviewed a number of scheme accounts and have found this information is generally already disclosed under AASB 7 as suggested in the submissions. Because AASB 7 already considers this information as part of general reporting obligations, we do not consider this to be commercially sensitive. We have clarified our guidance by stating that responsible entities need only disclose information that is reasonably required by investors.

Regarding submissions on the 10% fall in asset value causing a breach of a facility covenant, we have amended the disclosure principle to state that 'the amount (expressed as a percentage) by which either the operating cash flow or the value of the asset(s) used as security for the facility must fall before the scheme will breach any covenants in any credit facility'.

See updated RG 46 at RG 46.78–RG 46.86.

Disclosure Principle 4: Portfolio diversification

71 In CP 163, we proposed that responsible entities disclose the following additional information about a scheme's portfolio:

(a) whether the current assets of the scheme conform to the investment strategy of the responsible entity for the scheme with an explanation of any significant variance from this strategy;

(b) the current value of the development and/or construction assets of the scheme as a percentage of the current value of the total assets of the scheme; and

(c) if a scheme is involved in property development, for each significant development asset:

(i) the development timetable with key milestones;

(ii) a description of the status of the development against the key milestone identified;

(iii) a description of the nature of the funding arrangements for the development (including sources of funding and repayment strategies where borrowing is used to fund the development);

(iv) the total amounts of pre-sale and lease pre-commitments, where applicable;

(v) whether the loan-to-valuation ratio for the asset(s) under development exceeds 70% of the 'as is' valuation of the asset(s); and

(vi) the risks associated with the property development activities being undertaken.

72 We also proposed to give guidance that any scheme with over 20% of its property assets in development should clearly be defined as a development and/or construction scheme.

73 About half of the respondents agreed with our proposal, with one respondent stating that the disclosure would help investors assess the development risk in the scheme, with the qualification that undisclosed development risk was not a frequent occurrence.

74 One respondent found this proposal unnecessary because responsible entities are already obliged to not be misleading and deceptive in terms of conforming to investment strategies.

75 Another respondent agreed with our proposal and stated that the additional disclosure for property development outlined in CP 163 would help retail investors gain a closer understanding of the risks associated with achieving the developed values.

76 A suggestion made by another respondent was that key milestones should be specified in the disclosure document to ensure consistency in reporting milestones. They suggested using land settlement, planning approval, construction commencement and completion, sales settlement, and project finalisation as examples.

77 There was also a view that the disclosure principle should be expanded to include the estimated value of the development on completion as a percentage of total current assets. This would give investors an idea of the impact the completed development would have on the overall portfolio diversification because a project in the early stages represents a much smaller percentage of the portfolio.

78 One respondent stated that they would welcome ASIC guidance on whether a refurbishment of an asset constituted development under the proposal, and when a development asset is considered to be significant.

79 A few respondents stated that material amounts of management time and money would be expended to comply with this disclosure principle, considering the level of detail proposed on a six-monthly basis, particularly when some schemes have a significant number of development assets.

80 About half of the respondents agreed with the proposed level of 20% for a development and/or construction scheme, but said they required further guidance on what assets should be included in the calculation. It was suggested we provide a definition of the term 'development', and how that applies to refurbishment and redevelopment, for example.

81 We consulted further with industry and industry associations on what we considered to be an appropriate definition for development. We received a number of submissions, with one submission stating 33% would be more appropriate and another stating that 20% was too low.

ASIC's response

The milestone examples suggested by one respondent to promote consistency in reporting—including land settlement, planning approval, construction commencement and completion, sales settlement, and project finalisation—are valid examples of milestones.

We would expect information about the project milestones to be on hand with any major development project and that material amounts of extra time and money would not be needed to disclose this type of information. We believe this information, such as land settlement and planning approval, is generally prepared by the project manager for funding applications. We believe this to be an important disclosure for investors in schemes with development assets.

For the purposes of this disclosure principle, when we refer to development, we will not consider that refurbishment falls under this category. We provide further guidance in updated RG 46 at RG 46.87–RG 46.97.

We also state that any responsible entity for any scheme that has over 20% of its property assets in development based on an 'as if complete' basis should ensure that the scheme is clearly and prominently identified as a development and/or construction scheme.

Disclosure Principle 5: Valuation policy

82 In CP 163, we proposed to remove RG 46.68 and RG 46.71 if Benchmark 4 was introduced. If Benchmark 4 was not introduced, we proposed to revert to the existing wording in Disclosure Principle 5.

83 All of the respondents agreed with the proposal that if Benchmark 4 were implemented, RG 46.68 and RG 46.71 would be unnecessary.

ASIC's response

Disclosure Principle 5: Valuation policy has been deleted and replaced by Benchmark 4: Valuation policy: see updated RG 46 at RG 46.45–RG 46.52.

Disclosure Principle 6: Related party transactions

84 In CP 163, we proposed that this disclosure principle should ensure responsible entities provide information consistent with Section E of RG 76 on related party transactions. To provide consistency, we proposed to amend Disclosure Principle 6 by addressing:

(a) the value of the financial benefit;

(b) the nature of the relationship;

(c) whether the arrangement is on arm's length terms, is reasonable remuneration, some other exception applies or we have granted relief;

(d) whether scheme members' approval for the transaction has been sought and, if so, when;

(e) the risks associated with related party arrangements; and

(f) the policies and procedures that the responsible entity has in place for entering into related party transactions, including how compliance with these policies and procedures is monitored.

85 Generally, respondents agreed with the proposal. One respondent stated that the related party policy should be available on the responsible entity's website.

86 Another respondent believed the proposal to be unnecessary because there are already significant related party obligations under the Corporations Act. They also stated that the proposal created an unlevel playing field because the burden of such disclosure appeared greater for responsible entities of unlisted property schemes.

87 Two respondents considered that immaterial related party disclosure and related party transactions at arm's length should not need to be disclosed because this will not promote clear, concise and effective disclosure. One respondent recommended changing the wording of the disclosure principle to state 'where a financial product benefit is material, the value of the financial benefit'.

88 One respondent asked for guidance and clarification on disclosing employment contracts as a related party transaction. They felt this element should be removed as there are already significant disclosure provisions in the Corporations Act.

ASIC's response

Related party transaction disclosure in RG 46 is not intended to be inconsistent with RG 76. We do not consider the disclosure principle in RG 46 goes any further than RG 76, which applies to all issuers of disclosure.

For employment contracts, we stated in the draft update of RG 46 attached to CP 163 that an employment contract *may* be an example of a related party transaction. We do not expect this to apply to all responsible entities and, as such, disclosure should be applied where relevant to the individual circumstances of the entity. In any event, this example has not been included in RG 46 for consistency with RG 76.

The amended principle is now Disclosure Principle 5: Related party transactions: see updated RG 46 at RG 46.98–RG 46.101.

Disclosure Principle 7: Distribution practices

89 In CP 163, we proposed to amend this disclosure principle by including the following additional information:

(a) whether the current or forecast distributions are sustainable over the next 12 months; and

(b) if the current or forecast distributions are not solely sourced from realised income, the sources of funding and the reasons for making the distributions from sources other than realised income.

90 Generally, most respondents agreed in principle with the proposal, but were concerned about forecasting. One suggestion was that if the responsible entity does not forecast, it should not need to disclose the information outlined in this disclosure principle.

91 One respondent observed that many responsible entities do not forecast for a variety of reasons, particularly due to legal risks and associated costs.

92 Another respondent stated that responsible entities make no promises about a particular amount of distribution and, if distributions are sustainable at a particular level for 12 months, no disclosure under this disclosure principle should be made.

93 Guidance was requested on two terms—'sustainable' and 'realised income'. The term 'realised income' is not defined and this respondent stated that, in practice, property schemes have differing views.

94 One respondent stated that the proposal disadvantages responsible entities of unlisted property schemes compared to other asset types making distributions.

ASIC's response

We understand respondents' concerns about forecasting and reiterate that unless a distribution is forecast and/or being paid, the source of the distribution and its sustainability need not be disclosed.

We expect information for this disclosure principle to be disclosed if forecasted distributions or current distributions are not being paid from cash available for distribution (excluding borrowing).

We provide examples of sources of current distributions: see updated RG 46 at RG 46.102(a).

We have amended this disclosure principle to be consistent with Benchmark 6: Distribution practices.

The amended principle is now Disclosure Principle 6: Distribution practices: see updated RG 46 at RG 46.102–RG 46.103.

Disclosure Principle 8: Withdrawal arrangements

95 In CP 163, we proposed to amend this disclosure principle to include the following additional information:

(a) whether the constitution of the scheme allows investors to withdraw from the scheme and the circumstances in which investors can withdraw; and

(b) any significant risk factors that may affect the unit price at which a withdrawal will be made.

96 Generally, respondents agreed with the proposal, although one respondent stated that unlisted property schemes were being singled out through additional risk factors that may affect the unit price.

97 Another respondent thought the PDS should emphasise that property trusts are a long-term investment and that investors should not expect property trusts to be similar to a mark-to-market equity.

ASIC's response

Generally, we consider that any impact on unit pricing should be disclosed as a matter of course; this applies to all products, not just unlisted property schemes.

The amended principle is now Disclosure Principle 7: Withdrawal arrangements: see updated RG 46 at RG 46.104–RG 46.107.

New disclosure principle: Net tangible assets

98 During the consultation period, we received submissions suggesting that disclosure of net tangible assets (NTA) for closed-end schemes should be included in the update to RG 46 because this information is important for retail investors in such schemes.

99 As we had not consulted on such disclosure in CP 163, we conducted further consultation with those parties that had provided submissions in response to CP 163, with a suggested calculation for NTA for consistency in disclosure across schemes. The majority of those that responded to the further consultation supported such an initiative.

ASIC's response

Disclosure of NTA will help investors better understand the value of the assets upon which the value of their unit is determined. Open-end schemes regularly disclose the NTA for the scheme or a similar measure, such as net asset backing or net asset value, to support the pricing of units in the scheme. Generally, this is not replicated for closed-end schemes.

We have added a new Disclosure Principle 8: Net tangible assets, stating that 'the responsible entity of a closed-end scheme should clearly disclose the value of the NTA of the scheme on a per unit basis in pre-tax dollars'.

For the formula we consider responsible entities should use to calculate NTA, see updated RG 46 at RG 46.108–RG 46.115.

Timing for implementing updated disclosure principles

100 In CP 163, we proposed 1 July 2012 as the commencement date for responsible entities to apply the updated disclosure principles in all up-front and ongoing disclosures for new and existing PDSs for unlisted property schemes.

101 Although not all respondents answered this question, only one respondent stated that the commencement date was impractical in light of other proposed disclosure obligations from December 2011, and suggested July 2013.

ASIC's response

In proposing the timing for implementation, we considered a number of factors, including giving industry sufficient time to amend their current practices.

With these factors in mind, we have amended the commencement date to 1 November 2012 to give investors the benefit of audited account information: see paragraph 58 of this report and updated RG 46 at RG 46.135–RG 46.139.

From 1 November 2012, all new PDSs for unlisted property schemes should include the benchmark and disclosure principle information. Any existing PDS that is in use as at 1 November 2012 should also be updated to include this information.

D Form of disclosure

Key points

In CP 163, we proposed to give additional guidance on how responsible entities can word and present PDSs and other documents in a clear, concise and effective manner.

Disclosure documents for unlisted property schemes should highlight key information in the first few pages and include an investment overview.

We also proposed that responsible entities need to specify the date that any ongoing disclosure is issued.

‘Clear, concise and effective’ disclosure

102 In CP 163, we proposed to revise our guidance about ‘clear, concise and effective disclosure’ to be consistent with our proposed guidance in Consultation Paper 155 *Prospectus disclosure: Improving disclosure for retail investors* (CP 155).

103 Generally, a PDS would be considered clear, concise and effective if it helps retail investors make informed decisions because it:

(a) highlights key information;

(b) uses plain language;

(c) is as short as possible;

(d) explains complex information, including technical terms; and

(e) is logically organised and easy to navigate.

104 Generally, most respondents agreed with this proposal and stated that guidance from ASIC on what constitutes clear, concise and effective disclosure would be welcome.

105 One respondent stated that although they supported the clear, concise and effective guidelines, they wanted the policy to be applied consistently by ASIC. They went further to state that ASIC cannot require clear, concise and effective disclosure, and then expect the responsible entity to include extensive valuations and reports.

106 Another respondent believed that gearing and interest cover disclosure would not achieve clear, concise and effective disclosure. Two respondents were concerned that disclosure against the proposed benchmarks and applying the disclosure principles was generally at odds with the push for shorter PDSs.

107 A question was asked whether ASIC proposed to issue this guidance only in RG 46 or in other regulatory guides for application by all issuers.

ASIC's response

Generally, we would consider a PDS to be clear, concise and effective if it highlights key information, uses plain language, is as short as possible, explains complex information and is logically organised and easy to navigate.

'Clear, concise and effective' disclosure should be read as a compound phrase so that each word qualifies the other. One word in the phrase should not be focused on at the expense of the others.

We consider the use of an investment overview with information that includes the benchmark and principle disclosure information will help a responsible entity achieve the clear, concise and effective goal: see paragraphs 108–109 of this report.

Investment overview

108 In CP 163, we proposed to give guidance that a PDS should include an investment overview in the first few pages that highlights information that is key to a retail investor's investment decision. The investment overview should cover the benchmark and disclosure principle information.

109 Generally, all respondents agreed with this proposal. The main query was again about making the PDS longer, which appears to be at odds with the current push for shorter PDSs.

ASIC's response

The first few pages of a PDS should include an investment overview that summarises the benchmark and disclosure principle information with balanced disclosure of the benefits and risks: see updated RG 46 at RG 46.130–RG 46.132.

The investment overview highlights information that is key to a retail investor's investment decision. Cross-referencing should be used in this section to help the investor find further information on any of the benchmarks and disclosure principles, if required.

Dating of disclosure

110 In CP 163, we proposed that a responsible entity should specify the date on any ongoing disclosure. While all respondents agreed with this proposal, two respondents stated that specifying the date on disclosure would mean the information was applicable at that date rather than being considered 'ongoing disclosure'.

ASIC's response

We state in our guidance that responsible entities should specify the date on any ongoing disclosure: see updated RG 46 at RG 46.147.

Appendix: List of non-confidential respondents

- Australian Property Institute
- Centuria Property Funds Limited
- Garnaut Private Wealth Pty Ltd
- McCullough Robertson
- McMahon Clarke Legal
- PricewaterhouseCoopers
- Property Council of Australia
- Property Funds Association
- RICS Oceania