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By email

Dear Kathy

ASIC Consultation paper 308: Review of RG 97

The Property Council would like to thank ASIC for the opportunity to provide comment on *Consultation Paper 308, Review of RG97 Disclosing fees and costs in PDSs and periodic statements.*

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, our schools, hospitals, retirement villages, shopping centres, office buildings, industrial areas, research, tourism and hospitality venues and more.

Executive Summary

The Property Council welcomes the direction in which ASIC is progressing through this consultation process. The Property Council strongly agrees with the stated aims of the fees and costs disclosures to ensure that "consumers who actively seek information about fees and costs receive transparent and usable fees and costs information to help them to: (a) make confident and informed value for money decisions; (b) compare products; and (c) understand the fees and costs charged to them."

These aims can only be achieved where consumers have the information they need to evaluate and compare each asset class on the same terms. We also welcome ASIC's acknowledgement that these consumer objectives are balanced with ensuring the fees and costs disclosure regime is practicable for industry.

Industry is very pleased to see that ASIC has adopted the recommendation from Mr McShane to exclude property operating costs from the disclosure regime. The removal of property operating costs from RG97 is a material step forward to ensuring that property is compared on the same basis as other investment classes.

However, there are features that remain in the proposed RG97 disclosure regime that will continue to result in property investments appearing more costly than other asset classes. This may have an adverse impact on investment decisions because investors are not able to make an informed balanced comparison between investment classes.

The critical issues are:

- **Operation of the interposed vehicle test:** we understand that ASIC's interpretation of "end investment" in the PDS test could lead to superfunds having to look through property fund vehicles and disclose transaction and acquisition costs at the asset level – whereas investments in other asset classes (eg. private equity, fixed interest and infrastructure) apparently do not require similar asset level disclosures (even where the underlying investment may be similar to property).

  The differing application of the interposed vehicle test could lead to distortionary asset allocation decisions as superfunds are under pressure from investors to reduce their disclosable fees and costs.

- **Disclosure of stamp duty:** stamp duty is a once off capital cost that is accounted for in the unit price and is different to other transaction costs (eg legal fees) as it is a tax imposed by government. The owner of the asset has no ability to avoid or reduce the amount of stamp duty imposed on a transaction.

  Industry is concerned that the distortion to cost calculations from stamp duty reporting requirements places property on an uneven playing field to other asset classes and is not meaningful for investors.

- **Proposed move to "single line" disclosure:** The proposal to combine investment fees and investment costs in the proposed RG97 fees and costs disclosure regime creates another issue for property due to the higher costs that property has to report compared to other assets. Being able to clearly distinguish fees and costs provides superfunds with the opportunity to explain that asset allocation is driving the fees/costs and reflects the costs of investing in that asset class (and not payments taken by the trustee).

- **Clarifying scope of "Property Operating Costs":** Industry strongly supports the proposal not to require property operating costs, borrowing costs and implicit transaction costs to be disclosed in PDSs and periodic statements. The proposed amendments to RG97 do not provide any further explanation on what may be considered property operating costs. The type of operating costs incurred in the property sector can differ depending on the underlying asset class and we acknowledge it would be impossible to capture every cost in RG97.

These matters can be corrected through the following recommendations:

1. Elevating property in the interposed vehicle test from asset disclosure to entity disclosure – in line with other asset classes – would eliminate the distortionary impact of one-off transaction costs associated with property. This would level the playing field between

asset classes and ensure investors are provided with information that is not misleading or distortionary.
2. Exclude stamp duty from the fees and costs disclosures regime or allow it to be separately disclosed so that it is made clear that is a one-off transaction cost rather than a recurring cost.
3. Retain the current separation between 'investment fees' and 'investment costs' and allow superfunds to provide explanations for why different asset classes have different associated costs that are required to be disclosed.
4. Industry supports the exclusion of property operating costs from the disclosure regime. It may be helpful for RG97 to include indicative examples in the guidance materials, but it should not be seen to be an exhaustive list.

Each of these issues is discussed further in our submission below.

Role of property in a diversified investment portfolio

Property is seen as an essential part of a balanced and diversified investment portfolio, generating stable long-term returns for investors. As a result, there are 14.8 million Australians with a stake in property through their superfunds, and many also invest directly in property managed investment schemes (MIS). This investment underpins Australia's commercial property market, including world class office buildings, industrial precincts and shopping centres.

Looking ahead, Australia's need for investment will continue to grow strongly. Australia is the most urbanised country in the world and many of our cities are growing strongly. This growth will require significant investment in real estate and infrastructure to ensure our cities remain both liveable and continue to be engines of economic prosperity. We will need more homes, offices, retail centres, industrial sites, retirement living, student accommodation, hotels and community, cultural and sporting precincts. There is also a growing push to encourage superfunds to invest and support social and affordable housing to alleviate Australia's housing affordability challenges.

Superfunds and their investors are well placed to capitalise on these investment opportunities which provide long-term stable financial benefits for investors, shape our cities and regions and drive economic prosperity for the benefit of all Australians.

Interposed vehicle test gives rise to an unlevel playing field for property

Superfunds generally diversify their investments into the following broad categories: equities, fixed interest, private equity, infrastructure and property. Some funds are combining infrastructure and property into a broader category of 'real assets'. Generally, investments in infrastructure and property can be direct or through listed or unlisted funds. Private equity funds can also hold investments in infrastructure and property.

Under ASIC's proposed amendments to Schedule 10 of the Corporations Regulations, superfunds investing in property are required to report their transaction and acquisition costs – whereas investments in other asset classes, including private equity, infrastructure, listed and unlisted equities and fixed interest, apparently do not require similar asset level disclosures (even where the underlying investment may be similar to property).

We understand that the discrepancy in disclosures between property investments and other asset classes arises due to ASIC's interpretation of "end investment" in the PDS test in section 101B (4) of Schedule 10 of the Corporations Regulations (including the statutory extensions of the PDS test in sections 101B(4A) – (4D)). This is because superfunds and MIS investing in property (under section 101B (4)) are apparently required to look through property holding vehicles and disclose fees and costs incurred at the asset level, whereas investments in other asset classes are only required to disclose fees and costs at the entity level[1].

Property funds have parts of their structures that act as operational vehicles which incur similar levels of costs as other holding entities / operational entities at operational, acquisition and disposal level. However, under the interposed vehicle test in Schedule 10, property operators are required to disclose their acquisition and disposal costs while other operators apparently do not.

Distinguishing property from other asset classes in the interposed vehicle test disadvantages property when examined from an investor's perspective because transactional costs that need to be disclosed for property are excluded for other classes and thus makes property appear more expensive.

While the material impact of this distortion is to some extent reduced due to the welcome carve out of property operating costs, we note that transaction and acquisition costs for property are still required to be disclosed (as they have been deleted from the definition of Property Operating Costs in ASIC's mark-up of Schedule 10 of the Corporations Regulation). An example of a material transaction cost that property is required to disclose is stamp duty. Stamp duty can also be incurred by infrastructure and private equity funds, but apparently does not need to be disclosed.

If property looks more expensive because it is required to report asset level transaction costs when other asset classes do not, then investors will be discouraged from investing in property. Additionally, asset allocators in super funds will be forced to allocate away from allocating property into other portfolios or overseas direct investment. This could lead to a lessening in property investments in Australia which could reduce long term net returns for investors over the life of their investment.

Example: *To illustrate this, imagine there are two superfunds, both with a 10% allocation to "real assets" which can include property or infrastructure.*

Superfund A invests its 10% allocation in an infrastructure entity which owns an airport (Airport Holding Entity). In the relevant year, Airport Holding Entity acquires vacant land adjacent to the airport to expand the retail offerings available at the airport. Airport Holding Entity incurs stamp duty and other acquisition costs as a result of this acquisition.

Superfund B invests its 10% allocation in a wholesale commercial property fund which owns multiple retail centres. In the relevant year, the property fund acquires adjacent land to one of its retail centres to create an expanded mixed-use office and retail precinct. The property fund incurs stamp duty and other acquisition costs as a result of this acquisition.

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[1] We note in passing that the application of the PDS test in relation to property investments (including real property, wholesale property funds and REITs) has become very complicated. One consequence of this complexity is that, in our experience, the operation and application of the test in relation to property investment is not well understood. ASIC should consider whether further guidance (including by way of example scenarios) is necessary.

Under the interposed vehicle tests:

- *Superfund A will not be required to look through Airport Holding Entity, and will therefore not need to disclose any of the underlying costs incurred by Airport Holding Entity, including the stamp duty and associated acquisition costs; whereas*
- *Superfund B will be required to look through its investment in the wholesale commercial property fund and disclose all relevant transactional costs. The material impact of this is reduced due to the exclusion of property operating costs, however, in a year where there are material real property acquisitions, Superfund B will need to disclose significant stamp duty and acquisition costs.*

If Superfund A invested in a private equity fund, which then has an investment in a portfolio company that invested in commercial property, Superfund A would also not be required to look through the portfolio company and disclose any underlying transaction costs incurred.

The above example illustrates that a similar underlying investment can give rise to different fee and cost disclosures for superfunds and lead to distortionary asset allocation decisions as superfunds are under pressure from investors to reduce their disclosable fees and costs.

It could also make comparisons between funds difficult for investors – for example, if one superfund was investing in a property fund that was actively investing and managing its portfolio and therefore incurred significant transaction costs, it is likely to appear more expensive than a superfund that was not undertaking similar investments in that year.

***Recommendation:** Elevating property in the interposed vehicle test from asset disclosure to entity disclosure – in line with other asset classes – would eliminate the distortionary impact of one-off transaction costs associated with property. This would level the playing field between asset classes and ensure investors are provided with information that is not misleading or distortionary.*

Current disclosure of stamp duty is not meaningful information for retail investors

The discussion above regarding the differing treatment between investments in property and investments in other asset classes touched on the reporting of stamp duty costs (or more generally known as real estate transfer taxes). Industry is concerned that the distortion to cost calculations from stamp duty reporting requirements places property on an uneven playing field to other asset classes and is not meaningful for investors.

This is because:

- stamp duty is a once only capital cost that is already accounted for in the unit price. Funds also typically disclose a buy-sell spread which is calculated taking into account acquisition costs (including stamp duty) and the frequency of acquisitions. As a result, the cost of stamp duty is already disclosed to investors and any further disclosure around specific stamp duty costs would be double disclosure.

- stamp duty is different to other transaction costs (eg legal fees), as it is a tax imposed by government and the owner of the asset has no ability to avoid or reduce the amount of stamp duty imposed on a transaction.

The requirement to disclose stamp duty costs is impacting investment strategies as it is effectively encouraging Australian superfunds and MIS to reallocate their capital to offshore property markets that have little to no stamp duty liability, rather than Australian property markets. This would have significantly adverse impacts for future investment in the offices, industrial precincts, shopping centres and housing assets that Australia needs to underpin its growth and productivity.

There is an acknowledgement that explicit transaction costs should be disclosed as it will encourage investors to consider the cost effectiveness of outsourcing transaction execution (eg legal, technical, market due diligence). However, disclosing stamp duty incurred would be counter-productive as it is an unavoidable expense for investors seeking Australian property exposure. Therefore, the recommended practice is for stamp duty to be excluded from the RG97 disclosure regime.

Recommendation: *Exclude stamp duty from the fees and costs disclosures regime or allow it to be separately disclosed so that it is made clear that is a one-off transaction cost rather than a recurring cost.*

Single line disclosures could lead to less useful information for investors

The move to one-line disclosure in the proposed RG97 fees and costs disclosure regime creates another issue for property due to the higher costs that property has to report compared to other assets. This issue may be partly alleviated if the interposed vehicle test is amended and stamp duty costs are excluded as recommended above.

The original intention of the split between fees and costs was to create a distinction between:

(i) Investment fees charged by and/or paid directly by the trustee; and
(ii) Investment costs in relation to the underlying investment (i.e. costs other than Investment fees)

Having this distinction is important as it allows for clearer communication to investors. For example, a PDS may currently show[2]:

	Cash	**Australian Share**	**Infrastructure**	**Property**
Investment fees	5bps	50bps	94bps	60bps
Investment costs	0bps	0bps	30bps	53bps

Under the proposed single line approach, this would be summarised as follows:

	Cash	**Australian Share**	**Infrastructure**	**Property**
Investment fees and costs	5bps fees	50bps fees	124bps fees	113bps fees

[2] The information below has been extracted from the investment fees and costs section in a publicly available PDS of a large superannuation fund.

Being able to clearly distinguish between fees and costs provides superfunds with the opportunity to explain that asset allocation is driving the fees/costs and reflects the costs of investing in that asset class (and not payments taken by the trustee).

While superfunds may be able to influence the level of investment fees paid to a particular asset manager (eg through negotiation or selecting different managers), investment costs for property are usually outside the control of the superfund due to the inclusion of government taxes such as stamp duty. These 'costs' cannot be negotiated and are fixed to the underlying cost of having to do business in property.

The proposed consolidation of fees and costs into one single line item could lead investors to think that property is one of the most expensive asset classes when considering their options across equities, bonds, cash, private equity and property – this is further exacerbated currently due to the requirement to 'look through' property funds/holding vehicles, which appears not to be a feature of the disclosure regimes applicable to other asset classes.

This could then cause the investor to select a superfund which has a lower or no allocation to property. This will in turn cause superfunds to re-allocate away from property to other perceived ''lower cost" sectors. This will without a doubt have an impact on capital availability for Australian property over time, and adversely impact the growth of our cities and economic activity.

Keeping the calculation methodology consistent, or at least ASIC allowing the ability to 'explain further' would clarify to investors any extraneous costs. The current template precludes any ability to footnote or provide explanations to investors on how or why certain investment fees may appear overinflated. If investors are to make balanced and informed decisions, then having transparency is the key.

Similarly, removing rigid and government-imposed costs, such as stamp duty, from being disclosed will assist in providing a more readily comparable picture of product fees and costs to consumers. Property is disadvantaged by its requirement to disclose an inflexible cost imposed by governments. Other asset classes do not incur this cost (or if they do, are not required to disclose the costs in the same way), and as such are provided with a disclosure advantage.

While removing property operating costs from the disclosure regime is a fundamental change that brings property fees and costs disclosure closer to the disclosure regime applicable to other asset classes, the inclusion of transaction and acquisition costs and the merging of fees and costs into a single line disclosure has the potential to further hamper the treatment of property as compared to other classes.

Recommendation: *Retain the current separation between 'investment fees' and 'investment costs' and allow superfunds to provide explanations for why different asset classes have different associated costs that are required to be disclosed.*

Clarifying scope of "Property Operating Costs"

ASIC's proposal B6 acknowledges the consultation feedback, and proposes not to require property operating costs, borrowing costs and implicit transaction costs to be disclosed in PDSs and periodic statements.

We strongly support this proposal and acknowledge the rationale provided in the consultation paper that:

- such costs are not contemplated in consumer level fee and cost disclosure regimes anywhere except in Australia;
- it is unlikely that consumers would expect this type of cost to be included; and
- property operating costs are more closely related to the narrative about net returns than that relating to fees.

We also acknowledge ASIC's conclusion that this approach strikes an appropriate balance between providing information that may help consumers make informed value for money decisions and ensuring that the fees and costs disclosure regime is practicable for industry.

The proposed Schedule 10 of the Corporations Regulations has defined property operating costs as "amounts that are paid or payable in relation to the holding of real property or an interest in real property". The proposed amendments to RG97 do not provide any further explanation on what may be considered property operating costs.

Below is an indicative guide as to some of the operating costs incurred in the property sector:

- Property holding taxes, municipal rates
- Insurance costs
- Leasing fees (agency costs for leasing)
- Repairs and maintenance costs
- Security and access costs
- Lifts and escalators
- Fire protection
- Landscaping costs
- Cleaning costs
- Utilities (water, electricity, air)
- Car parking
- Pest control
- Property management costs

This list is not exhaustive, and it would be impossible to capture every cost as these can vary depending on the underlying asset class (eg operational costs of a shopping centre may include centre marketing costs, while operational costs of build-to-rent housing may include concierge services).

The Property Council is working with members to assess whether a voluntary practice note or template may be a useful tool to assist industry implement the RG97 reporting requirements, similar to the voluntary guide produced by the Property Council for RG46 *Improving disclosure for retail investors*.

Recommendation: *Industry supports the exclusion of property operating costs from the disclosure regime. It may be helpful for RG97 to include the above costs as indicative examples in the guidance materials, but it should not be seen to be an exhaustive list.*

Thank you for the opportunity to provide further information on this critical issue. We look forward to working with ASIC to ensure the RG97 fees and costs disclosure regime provides meaningful information to retail investors without inadvertently discouraging superfunds and MIS from investing in property which would jeapordise investor returns and the liveability of our cities.

We would welcome the opportunity to meet with you to discussion our submission further. Please contact Collin Jennings on (02) 9033 1979 or myself on (02) 9033 1929.

Yours sincerely

Belinda Ngo
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