Any complete or partial representation or reproduction, without the agreement of Mazars or Mazars’ successors or assigns, is illicit (cf. paragraph 1 of article 40 of the French law dated 11 March 1957).

Any such representation or reproduction, by any means whatsoever, would constitute an infringement sanctioned by articles L335-2 and following of the French code of intellectual property law. Paragraphs 2 and 3a of article L122-5 of that code only authorise “copies or reproductions strictly reserved for the copier’s personal use and not destined for any collective use” as well as “analyses and concise quotations” for purposes of example and illustration.
CONTENTS

INTRODUCTION

1. EUROPEAN REAL ESTATE COMPANIES’ POSITIONING

2. FINANCING AND HEDGING STRATEGIES

3. THE APPLICATION OF NEW IASs / IFRSs

CONCLUSION
INTRODUCTION

The tenth anniversary of the French SIIC regime provides us with the occasion of contemplating the path tread by listed European real estate companies since the turn of the century.

The regime, inspired by the REITs (Real Estate Investment Trusts) created in the USA in 1960, exempts real estate companies so constituted from corporate income tax in respect of their real estate transactions in exchange for their submission to obligations with regard to the distribution of dividends. It has been a decisive factor in providing real estate investment with a dynamic and liquid profile. The regime, now shared by 35 countries throughout the world, has enabled the emergence of genuine French “champions”.

The purpose of this survey of financial reporting practices is to review the evolution of the positioning and financing strategies of major European real estate companies over the past ten years or so and analyse the key features of their communication on those topics.

We have focused in particular on the readability, comparability and relevancy of the information provided under both the IAS / IFRS conceptual framework and the other conceptual frameworks mentioned in the course of our analysis.

We hope you will find the survey interesting.

Odile COULAUD, MRICS, Partner, Real Estate Services

Alexandre KASSE, Manager, Real Estate Services

Johan RODRIGUEZ, Manager, Real Estate Services
Between 2002 and 2007, following implementation of the SIIC regime in France in 2003 and of an equivalent regime in the UK in 2007, the number of REITs has significantly increased from 9 to 60.

Between 2007 and 2011, the overall number of players stabilised in Europe.

Since 2011, the number of REITs has fallen as a result of major new business combinations:

- The takeover and absorption of Silic by Icade initiated in 2011 and achieved in 2013;
- The rapprochements initiated in 2014 between Klépierre and Corio, Eurosic and SIIC de Paris, SMABTP and Société de la Tour Eiffel and recently Foncière des 6ème et 7ème arrondissements de Paris et Foncière de Paris.

**Evolution of the number of REITs in Europe since 2002**

![Graph showing the evolution of the number of REITs in Europe since 2002](image-url)
Scope of the survey
This year, we used the published financial information of a European panel of real estate companies as a basis for analysing the evolution in their financing strategies since the early 2000s.

Constitution of the panel
Our survey covered the annual reports and press releases of the twelve foremost listed European real estate companies based on their real estate holdings at 31 December 2013.

With the exception of Immofinanz, all the companies have REIT status.
Key data of the panel

€124 Billion of investment properties

€70 Billion of stock market capitalization

Structure and average size of the real estate companies’ annual reports

The average size of annual report has risen steeply since 2003 reflecting both greater emphasis on corporate social and environmental responsibility and more extensive coverage of entities’ governance and operations.

Great attention is now also paid to the aesthetic appeal and overall attractiveness of the annual report which has transcended its role as a regulatory financial report to become a fully-fledged vector of communication incorporating the main features of companies’ strategic orientations.
Rapidity of publication for 2013

Eleven of the real estate companies published their annual earnings press release during the 2nd month following the end of the financial year (with a range of between 34 and 59 days and an average of 50 days).

There is greater disparity for publication of the annual report with an average time-lag of 70 days after the year-end.

The average values and ranges are very similar to those observed for the companies of the STOXX Europe 50 stock market index (44 days on average for the press release and 66 for the annual report).

Limits of the survey

Our survey is not intended to cover the whole range of the financial reporting issues posed by listed real estate companies, or to provide any opinion as to the quality of the financial information published by the companies included in the survey.

The content of the survey and the opinions expressed therein are the sole responsibility of Mazars.

Over the last ten years, in a context of crisis involving profound mutation of the European economic environment and reducing access to bank credit, real estate companies have adapted their investment strategies and diversified their sources of financing.”

Odile Coulaud, MRICS, Partner, Real Estate Services
1. EUROPEAN REAL ESTATE COMPANIES’ POSITIONING

1.1. MARKET CAPITALISATION AND DISCOUNT AGAINST RNAV
1.2. BUSINESS SEGMENT AND GEOGRAPHICAL POSITIONING
1.3. RENTAL ACTIVITY INDICATORS
1.4. MANAGERIAL ORGANISATION
1.5. INNOVATION AND DIGITALIZATION
1.1. Market capitalisation and discount against RNAV

Trend in market capitalisations

Without exception, the real estate companies of our panel had regained, by 2013, their pre-crisis market capitalisations (for a total market capitalisation at the end of 2013 in excess of €70 billion).

---

1 Triple net NAV as defined by EPRA, or NNAV, i.e. revalued net assets increased by the fair value of the company’s financial instruments and fixed rate debt, and by the amount of deferred tax applicable to the revaluation of assets to fair value.

2 I.e. the portion of the share capital of a listed company not held by shareholders presumed to intend to retain their shareholdings indefinitely, and therefore potentially eligible to be traded in the market in the short term.
The level of free float has remained individually stable over the last ten years but differs from one company to another. Its average value of 66% as at 31 December 2013 masks three distinct profiles:

- Under 30%
- Between 30% and 60%
- Over 60%

Trend in market discount against RNAV and in stock market indices
The average level of market discount against companies’ revalued net asset values (RNAsVs) peaked in 2008, paradoxically so inasmuch as the sales of assets observed at that time took place at values close to the applicable professional valuations.

Since then, with the exception of a punctual fall in 2011, the market discount applicable to listed real estate companies has diminished to reach -7% at 31 December 2013, a level equivalent to that observed at the end of 2007.

“The phenomenon of structural stock market discount of the value of real estate companies, noted when the SIIC regime was created in 2003, is a thing of the past.”

Odile Coulaud, MRICS, Partner, Real Estate Services
At 30 June 2014, nine real estate companies were subject to market premium:

- **Unibail-Rodamco** disclosed 48% of market premium. The company is the one with the highest level of market liquidity. A component of the CAC 40 French stock market index, its development project portfolio amounted to €7 billion as at 31 December 2013.

- **Klépierre** disclosed 30% of market premium attributable in particular to its development pipeline for 2014-2018. Klépierre has announced a development plan amounting to €3 billion, in excess of 18% of its current gross asset portfolio measured at fair value.

- **Immofinanz**, in contrast, has suffered from a market discount of about 40% since 2008, due in particular to a “conglomerate” factor: a real estate portfolio covering both Eastern and Western Europe and constituting both residential and commercial assets. In this context, in March 2014 the company was divided into two entities: Immofinanz, which retains the commercial assets, and Buwog which has taken over the residential assets.
1.2. Business segment and geographical positioning

1.2.1. Evolution of the asset portfolios

Our panel’s asset portfolios are essentially invested in shopping centres and offices.

In 2013, those two business segments were subject to adequate liquidity and produced comparable returns with, for the panel:

- An average yield of 5.5%\(^3\) for office assets,
- An average yield of 5.2%\(^4\) for commercial assets.

---

\(^3\) Average yield for office assets communicated for the panel in 2013
\(^4\) Average yield for shopping centre assets communicated for the panel in 2013
Conversely, the portfolios do not contain any significant investment in logistics or residential assets.

The logistics segment of the market has the advantage of offering significant overall yield (8.2%\(^5\)), but is subject to a significant level of regulatory control and lesser liquidity. It is now greatly favoured by opportunistic investment firms such as Blackstone which acquired Gecina’s logistics portfolio in 2012 and 60% of the logistics assets of Foncière des Régions in 2014.

The tendency is to withdraw from the residential market in France, characterised by high rents and difficulties of management within an unstable regulatory environment. Conversely, the German residential sector has remained attractive with major transactions in 2013 on the part of Foncière des Régions via Foncière Développement Logements and of Immofinanz.

“\textit{The acquisition is in line with our overall strategy, which stipulates the continuous development of a strong portfolio in the northern German federal states}," says Daniel Riedl, CEO of BUWOG and COO of parent company IMMOFINANZ Group. \textit{"Berlin is still one of Germany’s most favourably priced large cities for rents and freehold flat prices. A process of catch-up has been underway for several years, however. The residential package just acquired will bring good long-term returns; the vacancy rate is low."}

20/11/2013 Press release – Immofinanz

\(^5\) Average yield for logistics assets communicated for the panel in 2013
1.2.2. Weight of the main business focus: towards a strategic refocus since 2011?

Since 2011, 8 real estate companies have communicated with regard to refocusing of their main business. They typically provide information as to the strategic dimension (or absence thereof) of their assets.

Extracts from press releases or annual reports:

With the sale of this non-strategic asset for the Group, in line with the decision taken in 2013, following the sale of the logistics and hotel portfolios, Gecina will complete the process to realign its portfolio.

20 02 2014 press release – Gecina

Klépierre signed a memorandum of understanding with Carrefour and a consortium of investors for the disposal of a 2 billion euros portfolio of retail galleries. This portfolio consists of 127 small to medium-sized retail galleries initially acquired from Carrefour in 2000-2001. Their disposal would significantly tilt the balance in Klépierre’s shopping center portfolio toward Klépierre’s key strategic regions and leading shopping centers.

2013 press release - Klépierre
Their financial reporting refers in particular to the distribution of their portfolio between “Prime” or “Core” assets.

"In 2013 and the first months of 2014, the real estate companies have reinforced the concentration of their assets by giving pride of place to “prime” criteria combining quality and security.”

Odile Coulaud, MRICS, Partner, Real Estate Services
1.2.3. Trend in business segment and geographical positioning

The companies’ business segment and geographical positioning has remained the same overall since 2009, with few exceptions:

- Immofinanz sold its operations in Austria in 2013;
- Foncière des Régions, as a result of the change in 2013 in the basis of consolidation of its residential operations in Germany and France;
- Klépierre has reinforced its operations in France in particular via the acquisition of Icade’s share of the Montpellier Odysseum shopping centre.
1.2.4. Assets under development

The value of assets under development reached €8 billion at the end of 2013; growth has been constant since 2003.

The level of reporting on assets under development has remained heterogeneous despite the recommendations of EPRA\(^6\) in favour of detailed disclosures.

**Number of real estate companies communicating on the following criteria**

*Criteria not required by EPRA

---

\(^6\) European Public Real Estate Association
We note that information is provided as to assets' location and type, but much less so with regard to other criteria such as their stage of completion or estimated rental values.

Hereafter we include two illustrations of their communication with regard to assets in the pipeline:

**2013 registration document – Unibail-Rodamco**

![Table of Consolidated Development Projects]

<table>
<thead>
<tr>
<th>Business</th>
<th>Country</th>
<th>City</th>
<th>Type</th>
<th>Total Complex GLA (m²)</th>
<th>GLA U-R scope of consolidation (m²)</th>
<th>Cost to date (KMe)</th>
<th>Expected cost (KMe)</th>
<th>Expected opening date</th>
<th>UR Yield on cost (%)</th>
<th>Project Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majunga</td>
<td>France</td>
<td>Paris Region</td>
<td>Greenfield/Brunofield</td>
<td>65,828</td>
<td>65,828</td>
<td>309</td>
<td>305</td>
<td>Hz 2014</td>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>2-8 Ancolie</td>
<td>France</td>
<td>Paris Region</td>
<td>Redevelopment/Refurbishment</td>
<td>35,536</td>
<td>35,536</td>
<td>30</td>
<td>37</td>
<td>Hz 2014</td>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>Forum des Halles Renovation</td>
<td>France</td>
<td>Paris</td>
<td>Extension/Renovation</td>
<td>15,059</td>
<td>15,059</td>
<td>60</td>
<td>142</td>
<td>Hz 2014</td>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>So Ouest Raza</td>
<td>France</td>
<td>Paris Region</td>
<td>Redevelopment/Refurbishment</td>
<td>40,700</td>
<td>40,700</td>
<td>68</td>
<td>188</td>
<td>Hz 2015</td>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>Taby Centrum Extension</td>
<td>Sweden</td>
<td>Stockholm</td>
<td>Extension/Renovation</td>
<td>28,790</td>
<td>28,790</td>
<td>268</td>
<td>330</td>
<td>Hz 2015</td>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>Mait of Scandinavia</td>
<td>Sweden</td>
<td>Stockholm</td>
<td>Extension/Renovation</td>
<td>99,410</td>
<td>99,410</td>
<td>33</td>
<td>609</td>
<td>Hz 2015</td>
<td>At cost</td>
<td></td>
</tr>
<tr>
<td>Polygone Riviera</td>
<td>France</td>
<td>Cagnes sur Mer</td>
<td>Greenfield/Brunofield</td>
<td>7,357</td>
<td>7,357</td>
<td>126</td>
<td>407</td>
<td>Hz 2015</td>
<td>At cost</td>
<td></td>
</tr>
<tr>
<td>Aupark Renovation</td>
<td>Slovakia</td>
<td>Bratislava</td>
<td>Extension/Renovation</td>
<td>578</td>
<td>578</td>
<td>8</td>
<td>35</td>
<td>Hz 2016</td>
<td>At cost</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td></td>
<td></td>
<td>2,468</td>
<td>2,468</td>
<td>20</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Committed Projects</strong></td>
<td></td>
<td></td>
<td></td>
<td>342,736</td>
<td>342,736</td>
<td>1,102</td>
<td>2,235</td>
<td></td>
<td></td>
<td>7.8%</td>
</tr>
</tbody>
</table>

**2013 annual report – Land Securities**

![Table of Retail Development Pipeline]

**TABLE 20 – Retail Development Pipeline as at 31 March 2013**

- **Property Development after practical completion**
  - Trinity Leeds: Retail, 100% ownership, 75,900 m², 89% letting status, £25.9, Feb 2013, £335, £377

- **Developments approved or in progress**
  - 185-221 Buchanan Street, Glasgow: Retail Residential, 10% interest, 10,700 m², 99% letting status, £4.7, Mar 2013, £46
  - Whalebone Lane, Chadwell Heath: Retail, 100% ownership, 5,700 m², 19% letting status, £1.3, Aug 2013, £14
  - Crawley: Retail, 100% ownership, 11,000 m², 94% letting status, £2.6, Nov 2013, £17
  - Bishop Centre, Taylor: Retail, 100% ownership, 976 m², 74% letting status, £2.7, Mar 2014, £20

Total development cost: Total development cost is the value of the land, the contractual price of the development, and the estimated capital expenditure related to the development, discounted to the dates of the financial year to which the property related to.

Net Income/ERV: Net income/erosion value represents the net income/erosion value of the property under development, discounted to the contractual date of the development. The net income/erosion value is calculated on the net rental income of the property, taking into account the risks associated with the development.
“More and more, real estate companies are communicating on the criteria applicable to their assets under development. Ambitious office and commercial projects are underway, often in partnership with local government authorities. The phenomenon of ambitious and capitalistic large projects, for example in Marseille, Bordeaux and Lyon, can be expected to continue.”

Odile Coulaud, MRICS, Partner, Real Estate Services
1.3. Rental activity indicators

1.3.1. Communication in respect of the indicators recommended by EPRA

EPRA recommends the presentation of several performance indicators designed to improve the transparency and comparability of the financial statements of listed real estate companies in Europe. They include the following:

- EPRA cost ratio (except cost of vacancy)
- EPRA cost ratio (cost of vacancy included)
- EPRA "topped-up" rate of return Net Initial Yield
- EPRA rate of return Net Initial Yield
- EPRA vacancy rate at period’s end
- EPRA NNAV by share
- EPRA NNAV
- EPRA NAV by share
- EPRA NAV
- EPRA earnings by share
- EPRA earnings

All the real estate companies in our panel communicated in respect of the value of their net assets or EPRA earnings.

The companies also communicated on the ratios introduced by EPRA in July 2013: cost ratios, inclusive or exclusive of the impact of vacancy, designed to present the industry’s administrative and operating costs in the most appropriate manner. They are calculated by expressing total operating costs (net of leasehold costs and the charges billed for management of third party assets) and administrative costs (net of exceptional items) as a percentage of gross rental revenue.
1.3.2. Concentration of tenants

IFRS 8 requires the provision of information on companies' degree of dependency with regard to their main customers. Within our panel, several different presentations coexist:

As illustrated below, British Land provides the nominative list of its 20 main tenants including the annualised rents provided by each of them, whereas Société Foncière Lyonnaise communicates on the proportion of total rental revenue provided by its 10 foremost tenants and by its 2 foremost tenants.

### OUR TOP 20 OCCUPIERS

<table>
<thead>
<tr>
<th>Rank</th>
<th>Tenant group</th>
<th>% of annualised rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tesco plc</td>
<td>7.7</td>
</tr>
<tr>
<td>2</td>
<td>Sainsbury Group</td>
<td>6.3</td>
</tr>
<tr>
<td>3</td>
<td>Debenhams</td>
<td>4.4</td>
</tr>
<tr>
<td>4</td>
<td>UBS AG</td>
<td>3.7</td>
</tr>
<tr>
<td>5</td>
<td>Home Retail Group</td>
<td>2.9</td>
</tr>
<tr>
<td>6</td>
<td>HM Government</td>
<td>2.6</td>
</tr>
<tr>
<td>7</td>
<td>Kingfisher (B&amp;Q)</td>
<td>2.3</td>
</tr>
<tr>
<td>8</td>
<td>Virgin Active</td>
<td>2.2</td>
</tr>
<tr>
<td>9</td>
<td>Arcadia Group</td>
<td>2.2</td>
</tr>
<tr>
<td>10</td>
<td>Next plc</td>
<td>2.2</td>
</tr>
<tr>
<td>11</td>
<td>Sainsbury Group</td>
<td>1.7</td>
</tr>
<tr>
<td>12</td>
<td>Alliance Boots</td>
<td>1.5</td>
</tr>
<tr>
<td>13</td>
<td>DSG International</td>
<td>1.5</td>
</tr>
<tr>
<td>14</td>
<td>Herbert Smith</td>
<td>1.4</td>
</tr>
<tr>
<td>15</td>
<td>Marks &amp; Spencer Plc</td>
<td>1.3</td>
</tr>
<tr>
<td>16</td>
<td>Royal Bank of Scotland plc</td>
<td>1.3</td>
</tr>
<tr>
<td>17</td>
<td>Hutchinson Whampoa</td>
<td>1.3</td>
</tr>
<tr>
<td>18</td>
<td>Asda Group</td>
<td>1.2</td>
</tr>
<tr>
<td>19</td>
<td>House of Fraser</td>
<td>1.1</td>
</tr>
<tr>
<td>20</td>
<td>New Look</td>
<td>1.0</td>
</tr>
</tbody>
</table>

profit. At 31 December 2013, our top ten tenants accounted for around 41% of total rental revenue and the top two for roughly 13%. Some 30% of tenants operate in the financial services and
1.3.3. Average residual duration of leases

The average residual duration of companies’ leases, which is also part of EPRA’s best practice recommendations, is an element securing future cash flows. All the real estate companies provide information with regard to this indicator but only half of them provide a clear and direct vision of the average residual maturity.

Below is an illustration of a presentation of the average residual maturity of leases broken down by maturity, by sector and by geographical zone and including an indication of the irrevocable portion.

![Average maturity by calculation](image)

Below is an illustration of a presentation of the average residual maturity of leases broken down by maturity, by sector and by geographical zone and including an indication of the irrevocable portion.

### LEASE EXPIRIES AND BREAKS AS AT 31 DECEMBER 2013

<table>
<thead>
<tr>
<th></th>
<th>Rents passing that would break in 2014</th>
<th>Rents passing that would break in 2015</th>
<th>Rents passing that would break in 2016</th>
<th>ERV of leases that expired/break 2014</th>
<th>ERV of leases that expired/break 2015</th>
<th>ERV of leases that expired/break 2016</th>
<th>Weighted average remaining lease term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>2.0%</td>
<td>2.0%</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shopping centers</td>
<td>1.7%</td>
<td>2.9%</td>
<td>5.1%</td>
<td>9.2%</td>
<td>18.6%</td>
<td>28.1%</td>
<td>28.1%</td>
</tr>
<tr>
<td>Retail parks</td>
<td>1.0%</td>
<td>2.9%</td>
<td>3.9%</td>
<td>4.3%</td>
<td>15.2%</td>
<td>18.3%</td>
<td>18.3%</td>
</tr>
<tr>
<td>Other UK</td>
<td>0.3%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Total United Kingdom</td>
<td>1.7%</td>
<td>2.9%</td>
<td>5.1%</td>
<td>9.2%</td>
<td>18.6%</td>
<td>28.1%</td>
<td>28.1%</td>
</tr>
<tr>
<td>France: Retail</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Group</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Other UK</td>
<td>0.3%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Total Group</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

**Notes:**
1. The amount by which rental income, based on rents passing at 11 December 2013, could fall short of the event that occupational leases due to expire are not renewed or replaced by new leases. For the UK, it includes certain break options for leases. It is based on the date of lease expiry.
2. The ERV at 31 December 2013 for leases that expire or break in each year and ignoring the impact of rental growth and any rent free periods.

---

Annual report 2013 – Hammerson
1.4. Managerial organisation
Within the changing business environment, the real estate companies have rethought and adapted their managerial functions. Via their financial reporting, the companies reviewed often evoke a more transversal and structured model, opting either for concentration of their organisation or for structuring by business line.

Extracts from 2013 annual reports
OUTLOOK: THE INTRODUCTION OF A NEW ORGANIZATIONAL STRUCTURE.

As soon as I joined Gecina in June 2013, I launched a major restructuring program to give Gecina the resources it needed for a new phase in its development. This program will come into effect in the first quarter of 2014. As a result of this reorganization, operational teams, which were previously organized "vertically" by product, i.e. in silos, will henceforth work "horizontally" across business lines. For example, three multi-product divisions will be created: Investments and Transactions, Asset Management, and Property Holdings.

Gecina, annual report 2013

2.9.1.3. New organisational structure reflects "customer-oriented approach"

In promoting customer relations and operational effectiveness and to reinforce synergies in skills and practices amongst the different asset classes, in September 2013, Foncière des Régions brought together all the operational lines including Asset Management, Tenant relations and Property Management and Real Estate Engineering under a new Operations Department. This has led to business lines developing added value and cross-discipline functions.

Foncière des Régions, annual report 2013

Through greater alignment of our organisational structure, we have sought to bring increased coordination and collaboration to our teams.

In particular, the increasing importance of multi-channel retail has led to the creation of a Group-wide marketing function, combining our UK and French teams. This important change enables a more cost-effective and coordinated approach to delivering our multi-channel strategy, as well as coordinating local and central marketing activities.

Opportunities for progression and increased responsibility for some of our talented asset managers were also implemented during the year following a management restructure in our French business.

Hammerson, annual report 2013

'Stage-focused structure will enable us to focus all of our operational teams on the inherent strengths of value creation and asset management. It will reinforce SF2’s positioning as the leader in the prime office real estate sector in Paris and support the ambitious development of our activities,’ states Dimitri Boule, Deputy Managing Director and Chief Operating Officer of the Société Foncière Lyonnaise.

Société Foncière Lyonnaise, press release 31/03/2014
1.5. Innovation and digitalisation

In a context of digitalisation and increasing levels of e-commerce, the real estate companies focused on retailing emphasise the importance of innovation and diversification as vectors for improving the attractiveness of their shopping centres and seem to be more and more positioned on the virtual path preceding the physical act of shopping.

Since 2012 and the acquisition of the Rue du Commerce website by Altarea Cogedim, the real estate companies focused on retailing are engaged, via new digital tools, in developing direct relationships with their shopping centre final customers: website, smartphone applications and Facebook pages.
2. FINANCING AND HEDGING STRATEGIES

2.1. FINANCING STRATEGY
2.2. HEDGING STRATEGY
2.1. FINANCING STRATEGY

Following their confrontation with what has been qualified as the “wall of debt” and experience of the uncertain climate associated with the banking sector’s relative withdrawal from the refinancing of real estate assets, the real estate companies have sought to diversify their sources of financing.

2.1.1. Trend in total new financing (in billions of euro)

The review of finance obtained since 2004 illustrates both the increasing share of bond financing over the past five years and the existence of two peak financing periods.

“The real estate companies have reacted to the liquidity crisis by diversifying their sources of finance. Since 2011, within a context of interest rates that have become lower than the yield of real estate assets, they have been encouraged to seek their finance in the market for bonds. The major real estate players are currently able to develop an immediate response in the event of punctual requirements thanks to their available credit lines.”

Philippe Thel, Director of BNP Real Estate Finance Europe
All the real estate companies included in our panel communicate on the composition of their debt and key indicators such as LTV\textsuperscript{7}, debt maturities, the average cost of debt and ICR\textsuperscript{8}. But they do not always provide all the definitions required to understand the bases of calculation of the indicators reported.

### 2.1.2. Consensus with regard to bond financing

Three types of debt structure may be distinguished:

- **Mainly financed by bonds**: 5 companies
- **Mainly financed by banks**: 3 companies
- **Mixed financing**: 4 companies

---

\textsuperscript{7} Loan To Value (cf. p. 28)  
\textsuperscript{8} Interest Cover Ratio (cf. p. 30)
It may be noted that the first category is very much the preserve of the British real estate companies, including for example Hammerson, Land Securities and British Land all of which have in excess of 80% of debt financing. The proportion of debt financing now amounts to more than 40% for 9 real estate companies out of our panel of 12 (as against 5 in 2011).

Between 2011 and 2013 the companies’ overall level of debt was relatively stable, in line with the stability of their new investment between 2011 and 2013, but the proportion of bond funding within the overall total rose steeply from 35% in 2011 to 52% in 2013. It may also be noted that in 2013, all the companies made at least one bond issue and their overall issues for the year totalled more than €5 billion.

“Over the last two years, bond issues have become the real estate companies’ main financing tool.

2014-2015 may well see the emergence of new types of bond funding and securitisation arrangements.

But that will not mean the end of bank financing for the real estate sector, which will continue to have recourse to the banks for juggling between its short-term and long-term requirements.”

Odile Coulaud, MRICS, Partner, Real Estate Services
2.1.3. Trend in debt ratios

a) The LTV ratio

Real estate companies generally communicate in terms of their LTV ratio rather than the gearing ratios habitually used by other industries. The ratio, which compares net debt to the fair value of the company’s assets, enables assessment of the company’s financial risk profile.

Given that the basis of calculation of the LTV ratio may vary from one company to another, it is not easy to use the indicator for purposes of precise comparison between the companies of our panel, only 2 of which provide the details of their calculation whereas 11 provide only a broad definition.

The main divergence relates to the treatment of registration duties:

- 3 companies include duties,
- 2 exclude duties,
- 6 make no mention of duties.

There follows an example of an LTV ratio calculation:

![LTV ratio calculation example](image-url)
Comparison of loan-to-value and yield?

Analysis of the yield rates applicable to office and commercial premises discloses similar trends to that of the LTV ratio.

“Given that real estate companies have significant financing requirements, we may wonder why, in a context of historically low rates, they have not sought to increase their levels of debt. The answer to this question lies in the lessons learned from the financial crisis: ever greater awareness of the importance of liquidity. Certain companies, seeking to reduce their gearing, have even downsized by selling non-core assets or refocusing their operations.”

Philippe Thel, Director of BNP Real Estate Finance Europe
b) The ICR ratio

ICR (the interest cover ratio) enables assessment of real estate companies’ ability to cover their interest charges via their operating profit.

Although all our companies report this indicator, only 75% of them provide a precise definition of its calculation. The formula may vary from one company to another with regard to both numerator and denominator. Below is an illustration of the information provided in respect of ICR:

![Diagram of ICR calculation methods]

**Interest cover**
Underlying operating profit excluding trading property related items divided by the net finance cost plus interest on convertible bonds recognised in equity excluding the change in fair value of financial instruments, exceptional finance costs and amortisation of compound financial instruments.

<table>
<thead>
<tr>
<th></th>
<th>Group 2013</th>
<th>Group 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest payable</td>
<td>(197.2)</td>
<td>(197.3)</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>0.6</td>
<td>0.2</td>
</tr>
<tr>
<td>Interest on convertible bonds recognised directly in equity</td>
<td>(5.8)</td>
<td>(5.8)</td>
</tr>
<tr>
<td></td>
<td>(202.4)</td>
<td>(202.9)</td>
</tr>
<tr>
<td>Underlying operating profit</td>
<td>345.6</td>
<td>342.2</td>
</tr>
<tr>
<td>Remove trading property related items</td>
<td>(0.1)</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>345.5</td>
<td>342.2</td>
</tr>
<tr>
<td>Interest cover</td>
<td>1.71x</td>
<td>1.69x</td>
</tr>
</tbody>
</table>

2013 usual report – Intu
2.1.4. Lengthening maturities and reduced costs of servicing debt

Since the financial crisis of 2007 and the associated strong rise in real estate companies’ LTV ratios (sometimes to more than 55%), the companies have deployed refinancing action plans designed both to increase the average maturity of their debt portfolios and to reduce their LTV ratios to a level closer to 40%.

Since 2011, falling interest rates and the success of our real estate companies’ bond issues have allowed 11 of the companies in our panel to report a downward trend in their average cost of debt.
2.2. HEDGING STRATEGY

2.2.1. Hedging instruments employed

Real estate companies’ hedging instruments changed significantly between 2009 and 2013:

- Less use of options;
- More use of swaps providing floating rate exposure for fixed rate debt, given the rising cost of bond financing;
- Less use of swaps substituting fixed for floating rates, given the fall in bank borrowings.

The increase in recent years in the proportion of funding assured on the basis of fixed rate bond issues has fuelled the requirement for swaps providing floating rate exposure for fixed rate debt. But the overall level of hedging has tended to fall given the existence of ever lower market rates of interest.
2.2.2. Extent of hedging

All our real estate companies report the extent of their hedging of interest rate risk but not all provide details of the applicable bases of calculation.

Three principles are shared by all the companies in our panel:

- **Hedge interest rate risk**;
- Maintain a **prudent** level of cover in excess of 60% for all our companies;
- Maintain a **stable average maturity of the hedging undertaken**, in line with the underlying fixed rate debt.
The companies’ hedging policies are somewhat heterogeneous in terms both of scope and type of evolution. Since 2012, 7 of our companies have tended to reduce their levels of cover.

“The real estate companies need to improve their communication with regard to their hedging strategy which is currently kept a matter of some secrecy. The fall in the extent of their cover has been the consequence of very active management leading companies to unwind their positions within the overall context of historically low interest rates accompanied by weak rent indexing. Despite the cost of unwinding, that strategy has improved ICR, reduced net borrowing costs and bolstered overall yield.”

Philippe Thel, Director, BNP Real Estate Finance Europe
2.2.3. Application of hedge accounting

Different choices as to the option for applying hedge accounting exist within the panel. Eligibility for hedge accounting is defined by IAS 39 which imposes onerous requirements for documentation of hedging relationships.

![Bar chart showing application of hedge accounting IAS 39](image)
3. THE APPLICATION OF NEW IASS / IFRSS

3.1. NEW CONSOLIDATION STANDARDS

3.2. IFRS 13, FAIR VALUE MEASUREMENT
The main IFRSs obligatorily or optionally applicable with effect from 1st January 2013 are as follows:

- The “consolidation package” comprising IFRS 10, IFRS 11, IFRS 12, IAS 28 (revised) and IAS 27 (revised);
- IFRS 13 and the latest amendment to IFRS 7;
- IAS 19 (revised), Employee Benefits (not analysed in the present survey);
- The amendment to IAS 1 on Presentation of Items of Other Comprehensive Income (not analysed in the present survey).

3.1 New consolidation standards

The “consolidation package” published by the IASB in May 2011 (with transitional provisions followed by amendments published in June 2012) is obligatorily applicable to European issuers for their accounting periods beginning on or after 1st January 2014, i.e. a year later than the general date of application fixed by the IASB. Most of the real estate companies in our panel have decided to wait till 2014 before applying the package, but they were nevertheless required to report on the expected impacts of application of the new standards.

Communication on the application of IFRSs 10-11-12

The only company of our panel to make early application of the consolidation package was Unibail-Rodamco.
Most of our companies report on the expected impacts of application, generally stating that no material implications have been noted.
3.2 IFRS 13, Fair Value Measurement

IFRS 13, published by the IASB in May 2011, was obligatorily applicable with effect from 1st January 2013. Its purpose is to provide a single IFRS framework for measuring fair value and define the full range of disclosures about fair value measurement.

Under IFRS 13, fair value is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. The definition gives priority to the concept of market value and to disposal price.

A fair value hierarchy with three levels, inspired by IFRS 7, has been defined in terms of the level of the input data as opposed to the valuation model used: the lower the level of the applicable inputs, the greater the volume of disclosure required. The three levels are defined as follows:

- Level 1 inputs are quoted (unadjusted) prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in markets that are not active;
- Level 3 inputs are unobservable inputs for the asset or liability, including in particular the entity’s own data.

Mazars’ publications:

- “Key points of IFRS 10, Consolidated Financial Statements, in 40 questions and answers”
- “IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A”
- “The application of the new standards on consolidation (IFRS 10 IFRS 11 and IFRS 12) in financial reporting as at 31/12/2013”
Financial instruments are generally measured using data of levels 1 or 2, whereas real estate assets are measured using data of levels 2 or 3.

Application of IFRS 13 for the measurement of derivative financial instruments

Under IFRS 13, the fair value of a derivative has to reflect the risk of non-performance:

- The CVA (Credit Valuation Adjustment) represents the risk of failure (credit risk) on the part of the banking counterparty, so constitutes an expense for the entity (a reduction of fair value for a derivative with an asset balance).
- The DVA (Debit Valuation Adjustment) represents the risk of failure (credit risk) on the part of the entity, so constitutes income for the entity (a reduction of fair value for a derivative with a liability balance).

Application of IFRS 13 for the measurement of real estate assets

Measurement must assume the “highest and best use” of the asset, i.e. that which would be retained by a market player acting in the player’s best economic interest.

In practice, the entity is presumed to engage ordinarily in optimal use but where (exceptionally) the highest and best use of a non-financial asset differs from its current use, the entity must disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.
Communication by our panel on the application of IFRS 13

Implications of IFRS 13 on the determination of the fair value of derivatives

IFRS 13 had little impact on the financial statements of our real estate companies as at 31 December 2013. Only two companies detailed the impact of their CVA and DVA adjustments for 2013.

However the standard also required increased disclosure with regard to entities’ valuation methods for derivatives and the underlying assumptions. All the companies possessing derivatives therefore communicated on their fair value hierarchy and provided details of their level 2 and 3 inputs (level 2 data was generally available)
Implications of IFRS 13 on the determination of the fair value of investment property

The provisions of IFRS 13 with regard to investment property had little impact on the financial statements of our real estate companies as at 31 December 2013.

The application of the standard nevertheless contributed to enriching the companies’ disclosure with regard to the overall valuation of their assets. The levels of the applicable inputs are systematically specified and all but one company provided description of those inputs and the associated valuation methods.

As recommended by EPRA, industry consensus was rapidly reached to conclude that measurement of the fair value of investment property should be classified as level 3 given in particular the presence of certain non-observable data elements used by valuation specialists (yield rates, discount rates and certain market-based leasehold values). It may be noted that 60% of the companies of our panel provided the ranges of estimates from which the non-observable data used was selected.

Publications Mazars:
- “IFRS 13, Fair Value Measurement, key points of the new standard in 40 Q&A”
- Impact of the new standard IFRS 13 on the fair value of derivatives used by Corporates”
CONCLUSION

Financial reporting by our panel of real estate companies has been harmonised over the last ten years, thereby facilitating comparison between companies operating in the property sector, in particular thanks to the impetus provided by EPRA (European Public Real Estate Association) and national financial market regulators such as the AMF (Autorité des Marchés Financiers) in France or the FSA (Financial Services Authority) in the United Kingdom.

There remain however several areas for improvement (definition of the scope of interest rate hedging) and homogenisation (LTV and ICR ratios, disclosures with regard to assets under development).

Within a context of crisis and reduced access to bank financing, real estate companies have developed a focus on the market for bonds: but they must now find an appropriate balance between bank and bond financing to meet the full range of their short-term and medium-term requirements.

Despite the weakness of rent indexing in recent years, REITs have been resilient and preserved their level of recurring cash flow:

- By optimising their financing strategies; and
- Maximising their revenue via effective asset management policies.

To preserve their attractiveness for investors, listed real estate companies need to balance the composition of their portfolios between assets creating value and assets securing cashflows adequate to fund their dividend distribution requirements.

Such is the price which needs to be paid to ensure that listed real estate companies retain pride of place within the overall real estate industry.
Mazars is spread across all 5 continents.

CONTACTS

Mazars
Real Estate Services

Odile Coulaud
MRICS, Partner
odile.coulaud@mazars.fr
Tél. : (+33) (0) 1 49 97 64 44

Alexandre Kasse
Manager
alexandre.kasse@mazars.fr
Tél. : (+33) (0) 1 49 97 67 41

Johan Rodriguez
Manager
johan.rodriguez@mazars.fr
Tél. : (+33) (0) 1 49 97 35 92

Mazars
61 rue Henri Regnault
92075 La Défense Cedex
Tél. : (+33) (0) 1 49 97 60 00
Fax : (+33) (0) 1 49 97 60 01