

MSCI Pan-European Quarterly Property Fund Index (Unfrozen)

CONSULTATION ON CHANGES TO INDEX INCLUSION CRITERIA

15 June 2021

This consultation may or may not lead to the implementation of any or all of the proposals mentioned. Consultation feedback will remain confidential. MSCI may publicly disclose the feedback of a participant if so requested by any participant. In that case, the relevant feedback would be published at the same time as the final results of the consultation.

Executive Summary

MSCI proposes changes to the MSCI Pan-European Quarterly Property Fund Index (Unfrozen) methodology (PEPFI)

- Changes to inclusion criteria and review of the rules
 - Proposal to standardize Net Asset Value (NAV) used for PEPFI
 - Proposal to amend inclusion rules and provide clarity to existing rules
 - Proposed quarterly review of inclusion criteria and introduction of observation period
- Objective
 - Enhance the index inclusion rules for PEPFI
 - Ensure index stability through quarterly review of eligibility of index constituents
 - Enhance governance and oversight on index composition
 - Enhance analytics for performance attribution and tenancy risk measurement
- Consultation Timelines
 - Consultation Launch: 15th June 2021
 - Consultation Completion: 30th July 2021
 - Planned MSCI Decision Communication: 27th August 2021
- Implementation (if adopted): Prospectively from Q1 2022 index results reporting

PEPFI Inclusion Criteria

CURRENT VS. PROPOSED RULES



Inclusion Criteria Changes – Current vs. Proposed Rules

Criteria	Current Rule	Proposed Rule
Minimum Direct Real Estate Allocation	Minimum 80% of Gross Asset Value (GAV)	Minimum 80% of Gross Asset Value (excl. Cash)
Regional Diversification	At the point of inclusion, fund should have an intended strategy to invest in at least 3 regions in Europe	At the point of inclusion and based on latest period data, fund should have investments in at least 3 regions in Europe with not more than 70% investment in any single region
Method of NAV Computation	As determined by International / Local accounting standards (or) as specified in the fund's articles of incorporation	In accordance with the INREV guidelines i.e., INREV NAV (non-adjusted)
Data Requirement for Index Inclusion	Funds are eligible for inclusion in the index only if, the underlying direct property performance is measured by MSCI at least quarterly	In addition to Direct Property data, the data provision of fund reconciliation and tenancy data provision is mandatory on a quarterly basis for inclusion of a fund in the index
Sub-Index criteria: Balanced funds	Based on sector diversification with no more than 70% investment in any single sector	Geography diversification as an additional criteria along with sector diversification i.e., not more than 70% in any single region in Europe

Inclusion Criteria Changes

PROPOSAL DETAILS



Method of NAV Computation | NAV Standardization

Background

- Feedback received from clients seeking standardization of Net Asset Value (NAV) for index calculation

Objective

- Reflect realizable economic value of fund's investments and liabilities as of reporting date
- Enhance comparability of performance for funds within the index
- Improve analytical offerings based on consistent NAV across index constituents

Proposal

- Adopt INREV NAV (non-adjusted) as a standard NAV for PEPFI index calculation
- Collect longest possible history for INREV NAV and include historical data changes in PEPFI
- If implemented, INREV NAV would be mandatory from Q1 2022 reporting

NAV Data Provision Status

- 70% Index NAV: 13 of 16 funds provide either INREV NAV (non-adjusted) or INREV NAV (adjusted)
 - 40% Index NAV: 7 of 16 funds provide INREV NAV (non-adjusted)
- 30% Index NAV: 3 of 16 provide IFRS NAV

Deriving INREV NAV from IFRS NAV

Based on INREV guidelines, a vehicle NAV calculated in accordance with IFRS is adjusted for the following items to calculate an INREV NAV:

		Itemized Adjustments
	NAV as per the IFRS financial statements	
A.	Reclassification of certain IFRS liabilities as components of equity	<ul style="list-style-type: none">• shareholder loans• hybrid capital instruments• undistributed dividend
=	NAV after reclassification of equity-like interests and undistributed dividend	
B.	Adjustment for re-valuation of assets and liabilities at fair value	<ul style="list-style-type: none">• Investment properties• Self-constructed or developed investment property• Investment property held-for-sale• Property leased to tenants under a finance lease• Real estate asset held as inventory• Other investments in real assets• Indirect investments not consolidated• Other financial assets and financial liabilities• Construction contracts for third parties

Deriving INREV NAV from IFRS NAV

	Adjustment Description	Itemized Adjustments
C.	Capitalization and Amortization of fund set-up costs and Property acquisition costs over 5yrs	<ul style="list-style-type: none">Cost of acquiring direct propertiesFund set-up costs
D.	Contractual fees that are unrecognized future liabilities	<ul style="list-style-type: none">Fees payable during or at the end of a fund's lifetime e.g., performance fees, disposal fees, liquidation fees
E.	Effects of the expected manner of settlement of sales/ vehicle unwinding	<ul style="list-style-type: none">Fair value of savings of purchaser's costs such as transfer taxesFair value of deferred taxes and tax effectEffect of subsidiaries having a negative equity (non-recourse)
F.	Other	<ul style="list-style-type: none">GoodwillNon-controlling interest effects
=	INREV NAV	

Discussion Points

Do you agree with our proposal to adopt INREV NAV (non-adjusted) for PEPFI Index calculation?

Do you agree to provide the data as per data provision timelines for PEPFI Index?

INREV NAV (non-adjusted) indicates that no further adjustments to IFRS NAV are made after the listed itemized adjustments

Fund Reconciliation and Tenancy Data Proposed as Index Inclusion Requirement

Proposal:

- Fund reconciliation and tenancy data as an index inclusion requirement
- Data to be provided to MSCI as per data provision timelines for the index

Objective:

- Timely availability of reconciliation analysis for funds as well as benchmark
- Enable completeness of data contributing to fund reconciliation and risk reporting analyses

Impact:

- Non-receipt of reconciliation and tenancy data as per data deadlines would result in exclusion of respective index constituent
- Currently some index constituents either don't provide this data or don't provide it within MSCI data deadlines

Fund Reconciliation

- Links the unlevered direct real estate return to the fund return
- Helps to assess the impact of investments and financial layers on fund's performance

Tenancy Data

- Helps measure risks associated with leases in a property
- e.g., Lease length, Rent reversion, Unexpired lease term, etc.

Discussion Points

Do you agree with the proposal of fund reconciliation and tenancy data as an index inclusion requirement?

Do you agree to provide the below as per data provision timelines for PEPFI Index?

Minimum Direct Real Estate Allocation

Proposal: Change the rule to, at least 80% of Gross Assets ([excl. cash](#)) invested in direct properties compared to 80% of Gross Assets invested in direct properties

Rationale: Measure direct real estate investment allocation as a ratio of operating assets excluding cash

Impact: As of Q4 2020, all index constituents meet the proposed inclusion criteria

#	Existing Inclusion Criteria	Proposed Inclusion Criteria
1	Only professionally managed pooled / commingled property funds providing access to direct property returns, where at least 80% of the Gross Asset Value (GAV) is invested in direct property in Europe, are eligible for inclusion in the Index. Funds of property funds, debt funds and property derivative funds are not eligible for inclusion within the Index	Only professionally managed pooled / commingled property funds providing access to direct property returns, where atleast 80% of the Gross Asset Value (excluding cash) is invested in direct property in Europe, are eligible for inclusion in the Index. Funds of property funds, debt funds and property derivative funds are not eligible for inclusion within the Index

Regional Diversification Criteria

Proposal: At the point of index inclusion and based on the latest period data, funds must have investment in minimum 3 regions of Europe and no region should represent more than 70% of fund's direct real estate capital value. At the point of inclusion, the fund will be included with full history.

Objective: Enhance the rule of geographical diversification for index inclusion

Rationale: Regional diversification indicates better representativeness of Pan-European funds

Impact: No Impact to index composition if the proposal is implemented

#	Existing Inclusion Criteria	Proposed Inclusion Criteria
5	Funds must have an intended strategy to invest in at least 3 regions of Europe (refer Appendix 6.1: Definition of Europe & Identified Regions for region definitions)	At the point of index inclusion and based on the latest period data, funds must have investment in minimum 3 regions of Europe and no region should represent more than 70% of fund's direct real estate capital value. At the point of inclusion, the fund will be included with full history. (refer Appendix 6.1: Definition of Europe & Identified Regions for region definitions)

Sub-index Criteria: Balanced Funds

Current Practice:

- The inclusion criteria is assessed only at the point of inclusion (based on the latest period)
- Balanced status of the fund is not reviewed for historical periods at the point of inclusion

Proposed Practice:

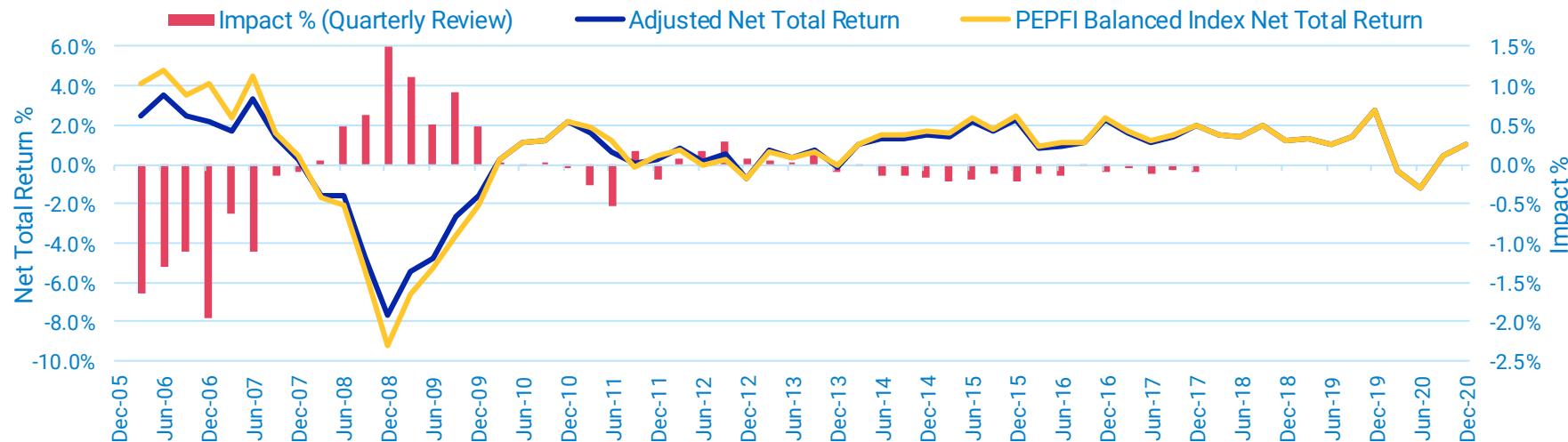
- Extend criteria assessment of balanced funds to be **diversified by 'Geography'** in addition to sector diversification
- At the point of inclusion, Balanced or Specialist status of new joiners to be [reviewed for individual quarters in history](#)
- After inclusion of a fund in the sub-index – the criteria is proposed to be reviewed on a quarterly basis

#	Existing Inclusion Criteria	Proposed Inclusion Criteria
16	Sector diversification requirement with no more than 70% investment in any single sector as per Global Property Type Classification (Retail, Office, Industrial, Residential, Hotel, Other)	Sector diversification criteria as per existing inclusion rule. Geography diversification as an additional criteria i.e., no more than 70% in any single region* in Europe. At the point of inclusion, Balanced or Specialist status of new joiners to be <u>reviewed for individual quarters in history</u> .

Simulated Impact Analysis | Sub-Index Total Return

Quarterly Review of Balanced Funds Criteria for Index History

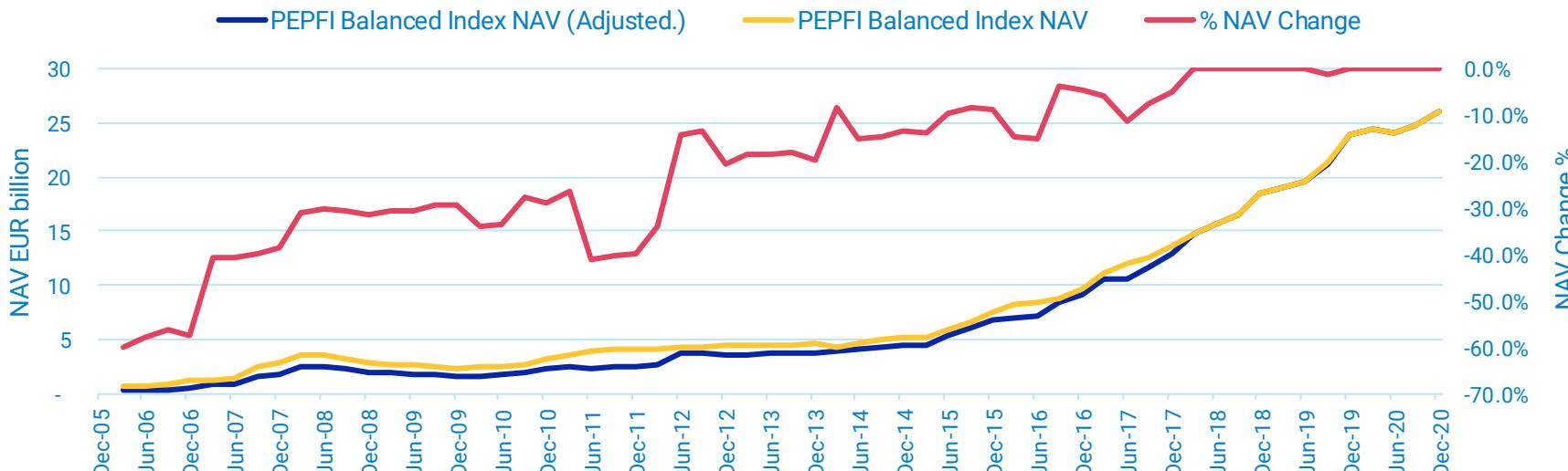
- Following chart shows the simulated impact on Net Total Return of Balanced funds Index, if the proposal for quarterly review of Balanced funds criteria would have been implemented historically
- No impact to total returns since Q1 2018 due to the quarterly review of balanced status
- The simulated impact on total return shows moderation with growing balanced funds index sample



Simulated Impact Analysis | Sub-Index NAV

Quarterly Review of Balanced Funds Criteria for Index History

- Following chart shows the simulated impact on the NAV of Balanced funds Index, if the proposal for quarterly review of Balanced funds criteria would have been implemented historically
- Historical impact prior to 2018 is largely driven by new joiners with history and thin sample of balanced funds index



Proposed Rewording of Existing Inclusion Criteria

Proposal: Rewording of the definition for better clarity

#	Existing Inclusion Criteria	Proposed Inclusion Criteria
2	<p>Only funds marketed as open or semi open-ended structures will be eligible for inclusion in the index. In case a fund closes to new contributions or redemptions for a sustained period of time, its inclusion in the index will be reviewed.</p> <p>Semi open-ended funds are classified as those where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life, during which either</p> <ul style="list-style-type: none">i. investors are not permitted to redeem their investmentii. or redemptions by investors are restricted to a maximum fixed percentage of their investment in any one	<p>Open ended and Semi open-ended funds are eligible for inclusion into the index. In case a fund closes to new contributions or redemptions for a sustained period of time, its inclusion in the index will be reviewed.</p> <p>Semi open-ended funds are open-ended funds where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life during which,</p> <ul style="list-style-type: none">a) investors are not permitted to redeem their investment, orb) redemptions by investors are restricted to a maximum fixed percentage of their investment in any one year

Discussion Points

1. Do you agree with the following change proposals to inclusion rules?
 - a. Minimum direct real estate investment exposure should be 80% of GAV (excl. Cash)
 - b. At the point of index inclusion, the fund should have investment in minimum three regions of Europe and no region contributing more than 70% of fund's direct real estate capital value
2. Do you agree with the following change proposals to the sub-index rules?
 - a. For the balanced funds sub-index, the criteria to be based on geographical diversification in addition to sector diversification
 - b. At the point of inclusion, Balanced or Specialist status of new joiners to be reviewed for individual quarters in history
4. Do you agree with the clarification provided to the rule on open-ended and semi open-ended funds?
5. Do you agree with the proposal to implement the inclusion rules on a moving forward basis from Q1 2022 results reporting?

Index Eligibility Requirements

QUARTERLY REVIEW PROPOSAL



Proposed Quarterly Review

- **Current Practice**

- Fund eligibility based on most inclusion criteria is assessed only at the point of initial inclusion
- No subsequent review of inclusion criteria to assess eligibility for index constituents

- **Proposed Practice**

- After index inclusion, a quarterly review of index constituents to assess their eligibility
- Introduce observation period (where applicable) aimed at index stability in case of temporary non-adherence
- Observation period applicable to specific inclusion rules
- Exclusion of funds not meeting the inclusion criteria requirements by the end of observation period
- Introduce the proposal on a moving forward basis starting Q1 2022 results reporting

- **Rationale**

- To keep the index composition aligned with index inclusion criteria on an ongoing basis rather than only at initial inclusion
- Ensure periodic governance and oversight on index composition and reporting

Proposed Introduction of Observation Period

- Observation period (four quarters) is a time window in which MSCI will monitor the existing index funds that are in temporary non-adherence to the criteria
- Non-adherence of a fund to inclusion rule for four consecutive quarters will qualify for exclusion from the index
- Funds would be re-admitted to the index as soon as the inclusion criteria is met

Potential benefits of Quarterly Review and Observation Period:

- Allow for index stability in case of a temporary non-adherence to inclusion rule
- Ensure consistency in composition
- Rules based index composition and governance

Rules in Scope of Quarterly Review

Quarterly Review

Open and Semi Open-ended funds requirement

*Fund's direct property performance measurement by MSCI at least quarterly

INREV NAV data provision on a quarterly basis as per data deadlines

Fund reconciliation data provision on a quarterly basis as per data deadlines

Tenancy data provision on a quarterly basis as per data deadlines

*NAV is based on the quarterly revaluation of at least 95% of the value of each fund's property portfolio

Eligibility rules for fund inclusion within balanced funds sub-index

Quarterly Review (with observation period: 4 quarters)

Minimum direct real estate allocation of a fund to be at least 80% of GAV (excl. Cash)

Fund suspensions / closure for new contributions and redemptions

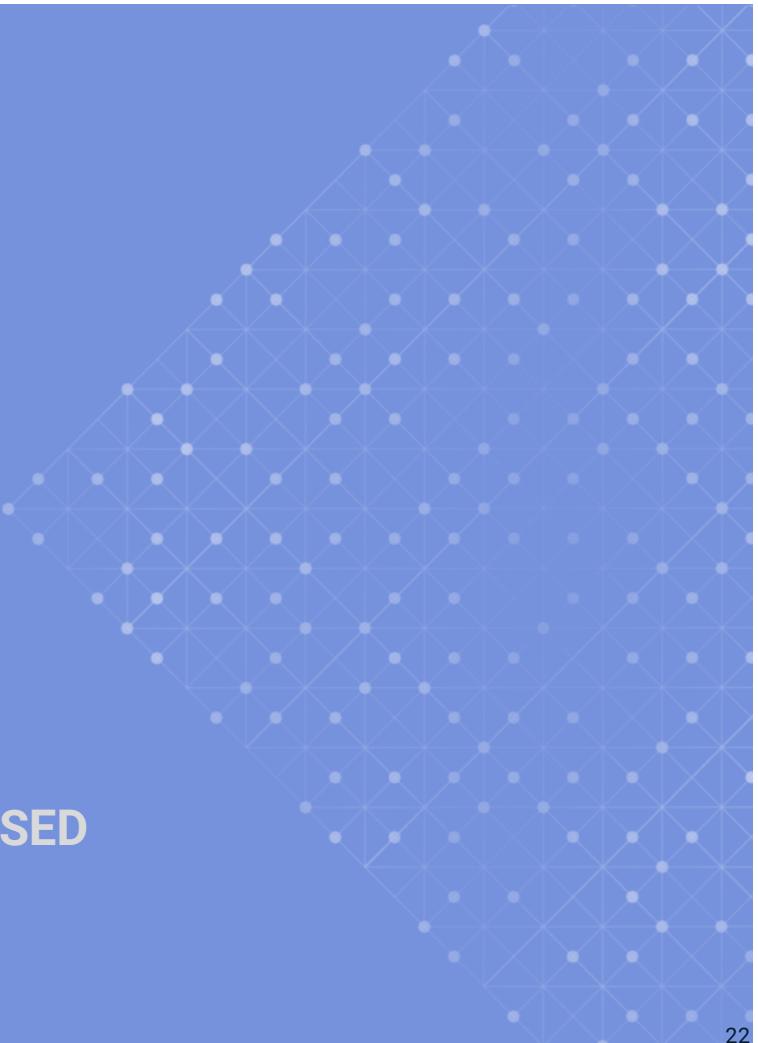
Fund leverage – not more than 60%

Discussion Points – Quarterly Review and Observation Period

1. Do you agree with the enhanced rule-based approach to perform quarterly review of eligibility of index constituents?
2. Do you agree with the identified list of criteria that is under the scope of quarterly review?
3. Do you agree with the proposal to introduce quarterly review on a moving forward basis?
4. Do you agree with the proposal to introduce observation period to address temporary non-adherence to inclusion rules?
5. Do you agree with the observation window of 4 quarters?
6. Do you agree with the list of criteria for which observation period would be applicable?

Appendix 1

DETAILED INDEX RULES – CURRENT VS. PROPOSED



PEPFI Inclusion Criteria – Change proposal

#	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
1	Only professionally managed pooled / commingled property funds providing access to direct property returns, where atleast 80% of the Gross Asset Value (GAV) is invested in direct property in Europe, are eligible for inclusion in the Index. Funds of property funds, debt funds and property derivative funds are not eligible for inclusion within the Index	Only professionally managed pooled / commingled property funds providing access to direct property returns, where atleast 80% of the Gross Asset Value (excluding cash) is invested in direct property , are eligible for inclusion in the Index. Funds of property funds, debt funds and property derivative funds are not eligible for inclusion within the Index	Yes
2	<p>Only funds marketed as open or semi open-ended structures will be eligible for inclusion in the index. In case a fund closes to new contributions or redemptions for a sustained period of time, its inclusion in the index will be reviewed.</p> <ul style="list-style-type: none"> • Semi open-ended funds are classified as those where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life, during which either <ul style="list-style-type: none"> i. investors are not permitted to redeem their investment ii. or redemptions by investors are restricted to a maximum fixed percentage of their investment in any one 	<p>Open ended and Semi open-ended funds are eligible for inclusion into the index. In case a fund closes to new contributions or redemptions for a sustained period of time, its inclusion in the index will be reviewed.</p> <p>Semi open-ended funds are open-ended funds where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life during which either,</p> <ul style="list-style-type: none"> a) investors are not permitted to redeem their investment, or b) redemptions by investors are restricted to a maximum fixed percentage of their investment in any one year 	Clarification
3	Only funds where the General Partner / Manager or equivalent for the fund has a discretionary mandate to manage its investments will be included in the Index	--	No change proposed
4	Fund should have been incorporated using a recognized legal structure	--	No change proposed

PEPFI Inclusion Criteria – Change proposal

#	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
5	Funds must have an intended strategy to invest in at least 3 regions of Europe (refer Appendix 6.1: Definition of Europe & Identified Regions for region definitions)	At the point of index inclusion, funds must have investment in minimum 3 regions of Europe and no region should represent more than 70% of direct real estate capital value in the fund. (refer Appendix 6.1: Definition of Europe & Identified Regions for region definitions)	Yes
6	Any fund joining the Index must have Net Asset Value (NAV) greater than EUR 200 Million.	--	No change proposed
7	Funds must carry no more than 60% leverage, where leverage is defined as the ratio of total debt to the fund's GAV	--	No change proposed
8	Funds will be included in the index only if all their underlying direct property performance is measured by MSCI at least quarterly.	<p>Funds are eligible for inclusion in the index only if,</p> <ul style="list-style-type: none"> • All their underlying direct property performance is measured by MSCI at least quarterly • The data required for fund reconciliation analysis is provided to MSCI, at least quarterly • Tenancy data for <u>non-residential</u> direct properties in the portfolio is provided to MSCI, at least quarterly 	Yes

PEPFI Inclusion Criteria – Change proposal

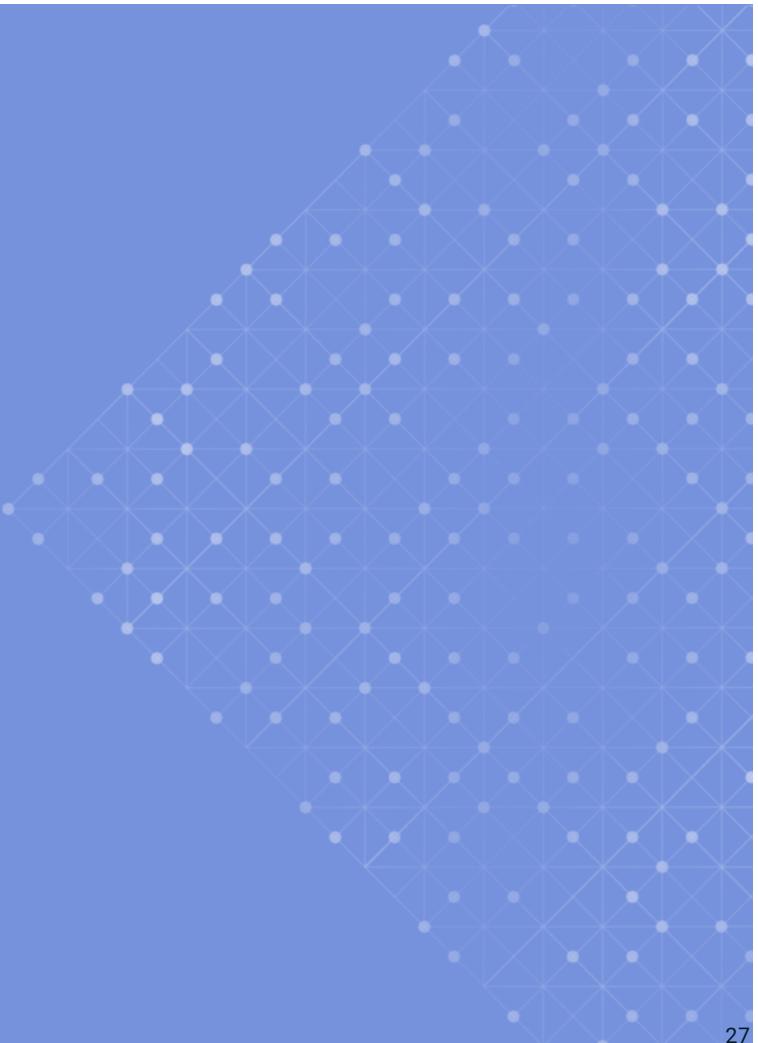
#	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
9	Funds are required to report their NAV per unit at least quarterly and should have done so for the whole of the period of their performance history within the Index.	--	No change proposed
10	The NAV should be based on the quarterly revaluation of at least 95% of the value of each fund's property portfolio (including the value of other assets held through joint/indirect investments, derivatives and cash)	--	No change proposed
11	The revaluation of the property portfolio should be undertaken using RICS red-book or similar principles and completed at least quarterly by a third-party appraiser.	--	No change proposed
12	New funds are required to provide sufficient and complete data to compile the longest possible history of their investment performance, subject to a minimum of either three years, or the period from the date of launch of the fund.	--	No change proposed

PEPFI Inclusion Criteria – Change proposal

#	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
13	Constituents of the Index must agree to calculate their NAV data on a consistent basis from quarter to quarter. The method of calculation should be either that specified in the fund's articles of incorporation, or a recognized methodology as determined by international or local accounting standards. Constituent funds must agree to disclose the basis of NAV computation to MSCI.	Constituents of the Index must calculate and report their NAV on a consistent basis from quarter to quarter. NAV should be calculated in accordance with the INREV guidelines i.e., INREV NAV (non-adjusted). Constituent funds should disclose the basis of NAV computation to MSCI.	Yes
14	Re-admitted funds are subject to the same eligibility requirements as potential new constituents.	--	No change proposed
15	In order to be re-admitted to the Index, the funds must provide MSCI with the data to calculate their investment performance during the whole period since their last inclusion in the Index.	--	No change proposed

Appendix 2

PROPOSED QUARTERLY REVIEW



Proposed Review – Eligibility of Index Constituents

#	Criteria	Review Frequency	Observation period
1.A	Only professionally managed pooled / commingled property funds are eligible for inclusion in the Index	--	--
1.B	Funds should have at least 80% of the Gross Asset Value (excl. Cash) invested in direct property	Quarterly	4 quarters
2.A	Open ended and Semi open-ended funds are eligible for inclusion in the index	Quarterly	--
2.B	In case a fund closes to new contributions or redemptions for a sustained period of time, its inclusion in the index will be reviewed.	Quarterly	4 quarters
3	Only funds where the General Partner / Manager or equivalent for the fund has a discretionary mandate to manage its investments will be included in the Index	--	--
4	Fund should have been incorporated using a recognized legal structure	--	--

Proposed Review – Eligibility of Index Constituents

#	Criteria	Review Frequency	Observation period
5	Funds must have direct property investment in at least 3 regions of Europe (for definition of regions, refer Appendix 6.1: Definition of Europe & Identified Regions)	--	--
6	The fund must have a NAV equal to or greater than Euro 200m	--	--
7	Funds must carry no more than 60% leverage, where leverage is defined as the ratio of total debt to the fund's GAV	Quarterly	4 quarters
8	Funds are eligible for inclusion in the index only if, <ul style="list-style-type: none"> • All their underlying direct property performance is measured by MSCI at least quarterly* • The data required for fund reconciliation analysis is provided to MSCI at least quarterly • Tenancy data for non-residential direct properties in the portfolio is provided to MSCI at least quarterly 	Quarterly	--
9	Funds are required to report their INREV NAV (non-adjusted) at least quarterly	Quarterly	--

Proposed Review – Eligibility of Index Constituents

#	Criteria	Review Frequency	Observation period
10*	The NAV should be based on the quarterly revaluation of at least 95% of the value of each fund's property portfolio (including the value of other assets held through joint/indirect investments, derivatives and cash)	Quarterly	--
11	The revaluation of the property portfolio should be undertaken using RICS red-book or similar principles and completed at least quarterly by a third-party appraiser.	--	--
12	New funds are required to provide sufficient and complete data to compile the longest possible history of their investment performance, subject to a minimum of either three years, or the period from the date of launch of the fund	--	--
13	Constituents of the Index must calculate and report their NAV on a consistent basis from quarter to quarter. The method of calculating NAV should be in accordance with the INREV guidelines i.e., INREV NAV. Constituent funds should disclose the basis of NAV computation to MSCI.	Quarterly	--

Proposed Review – Eligibility of Sub-Index Constituents

Sub-index	Criteria	Review Frequency	Observation period
MSCI Pan-European Balanced Funds Quarterly Property Fund Index (Unfrozen)	<p>MSCI Pan-European Balanced Funds Quarterly Property Fund Index : It comprises of funds whose portfolios are diversified:</p> <ul style="list-style-type: none">a) by property type so that no sector (i.e., retail, office, industrial, residential, hotel or other property) represents more than 70% of its total capital value.b) by geography so that no region (i.e., as per Appendix 6.1 of the PEPFI methodology document) represents more than 70% of fund's direct real estate capital value.	Quarterly	--

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