

# MSCI/AREF UK Quarterly Property Fund Index

## CONSULTATION ON INDEX INCLUSION CRITERIA

March 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.

# Contents

MSCI proposes to change the index inclusion criteria for MSCI/AREF UK Quarterly Property Fund Index (UK PFI)

- Proposal Summary:
  - Inclusion Criteria Change Proposal
  - Clarification to the treatment of funds closed of investments and redemptions
  - Re-wording proposal for better clarity of inclusion criteria
- Consultation Timelines:
  - Consultation Launch: 31 March 2021
  - Consultation Completion: 21 May 2021
  - Feedback Communication: 30 June 2021
- If implemented, change proposal to be implemented prospectively from Q1 2022 index results reporting
- Other Discussion Topics
  - Quarterly review and re-certification of inclusion criteria and introduction of observation period
- Changes to product offerings
  - Introduce Open-ended funds sub-index
  - Discontinue Low-Geared Balanced funds sub-index

# Inclusion Criteria – Change Proposal

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MSCI/AREF UK QUARTERLY PROPERTY FUND INDEX

# UK PFI Inclusion Criteria – Change proposal (Summary)

Rule #	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
1	The fund should not be listed on a stock exchange	The fund should not be listed on a stock exchange	
2	The fund should have a <b>minimum of 85% of their gross assets invested in the UK</b>	The fund should have a <b>minimum of 95% of their gross assets (excl. Cash) invested in the UK</b>	Yes
3	The fund should have the investment performance of their <b>direct property portfolio measured by MSCI at least annually, preferably quarterly</b> . The frequency of asset and fund data provision to MSCI must align with the valuation and reporting regime of the fund and must respect MSCI's data collection deadlines	The fund should have investment performance of its <b>direct property portfolio measured by MSCI at least quarterly</b> . The frequency of asset and fund data provision to MSCI must align with the valuation and reporting regime of the fund and must respect MSCI's data collection deadlines	Yes
4	The fund must be a full member of the Association of Real Estate Funds (AREF)	The fund must be a full member of the Association of Real Estate Funds (AREF)	
5	Be open to new investors or <b>have the possibility in the near future for investment by new investors</b> . Funds such as joint ventures (the investors in which are expected to remain unchanged during the life of the fund) are, therefore, not eligible for inclusion.	<p>The fund must be open to investment by new investors i.e.,</p> <ul style="list-style-type: none"> <li>i. fund registered as open-ended fund</li> <li>ii. Semi open-ended fund 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"> <li>a) investors are not permitted to redeem their investment , or</li> <li>b) redemptions by investors are restricted to a maximum fixed percentage of their investment in any one year</li> </ul> </li> <li>iii. fund registered as closed-ended but open to additional investors after one or more additional closings and the final initial closing of the fund</li> </ul> <p>Funds such as joint ventures (the investors in which are expected to remain unchanged during the life of the fund) are, therefore, not eligible for inclusion.</p>	Clarification on Criteria

# UK PFI Inclusion Criteria – Change proposal (Summary)

Rule #	Existing Inclusion Criteria	Proposed Inclusion Criteria	Change Proposal
6	Have a NAV equal to or greater than that of the 9th decile fund within the MSCI/AREF UK All Balanced Property Fund Index for the forthcoming measurement period at the point of the fund's entry into the index	The fund must have an NAV equal to or greater than GBP 100m at each measurement period from the point of inclusion	Yes
7	The fund must be listed within the MSCI/AREF UK Quarterly Property Fund Index market information products with individual fund performance, but not contribute to the Index, for their first period of data provision	The fund must be listed within the MSCI/AREF UK Quarterly Property Fund Index market information products with individual fund performance, but not contribute to the Index, for their first period of data provision	
8	The fund must value and report the Net Asset Value (NAV) at least quarterly (preferably monthly)	The fund must value and report the Net Asset Value (NAV) at least quarterly (preferably monthly)	
9	New fund is required to provide sufficient and complete data to compile the longest possible history of their investment performance, subject to a minimum of either five years, or the period from the date of launch of the fund	The fund must 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	Yes
10	The fund's NAV should be based on the valuation of at least 95% of the value of its property portfolio; The valuation must also cover properties held through joint or indirect investments such as shares in listed property companies and derivatives	The fund's NAV should be based on the valuation of at least 95% of the value of its property portfolio; The valuation must also cover properties held through joint or indirect investments such as shares in listed property companies and derivatives	

## Rule 2

# Minimum investment exposure within UK

The fund should have a minimum of 95% of their gross assets (excl. Cash) invested in the UK

- **Proposal:** Change to 95% of Gross Assets (excl. cash) compared to 85% of Gross Assets
- **Rationale:** Higher allocation to UK investments for better representativeness of UK PFI
- **Impact:** As of Q4 2020, all PFI constituents have investment exposure of more than 95% within UK

## Rule 3

# Direct property portfolio performance measurement by MSCI

The fund should have investment performance of its direct property portfolio measured by MSCI, at least quarterly

- **Proposal:** Change to quarterly frequency compared to annual frequency
- **Rationale:** Consistency in valuation/performance measurement practices between all funds in the index
- **Impact:** As of Q4 2020, funds contributing to 4.5% of Index NAV do not meet this criteria

## Rule 6

# Minimum NAV requirement for inclusion

### Minimum NAV requirement for inclusion

- **Proposal:** Change to GBP 100 million compared to 9<sup>th</sup> decile of UK All Balanced PFI NAV
- **Rationale:**
  - Simplify the inclusion criteria by using an absolute threshold for consistency
  - Restrict smaller funds from skewing the returns distribution analysis
  - Growth in funds' size over the years has resulted in 9<sup>th</sup> Percentile threshold increasing to ~GBP 200 mn
- **Impact:**
  - As of Q4 2020, all indexed funds are larger than the proposed minimum size requirement
  - Fund(s) with 0.6% of Index NAV could be potential inclusion to the UK PFI subject to other inclusion criteria being met
  - See [Appendix 1](#)



# Historical Data Provision Requirement

## Minimum Historical Data Provision Requirement where longest history is not available

- **Proposal:** Minimum 3 years historical data provision compared to the current requirement of 5 years
  - No change proposed to the requirement for data provision of longest possible history, where available
- **Rationale:** Relaxing the criteria as 3 years history is sufficient to carry out data quality checks and timeliness assessments
- **Impact:** Fund with 0.3% of NAV could be potential inclusion to the index subject to other inclusion criteria being met

# MSCI/AREF UK All Balanced Property Fund Index - Inclusion Criteria Change Proposal

- **Proposal:** Change the criteria to align with Global Property Type Sector Definition for MSCI/AREF UK All Balanced Property Fund Index
- **Rationale:** To align with a criteria that is based on globally consistent property type classification
- **Impact:** No impact to the index composition due to this proposal

## Existing Inclusion Criteria

Sub-index: MSCI/AREF UK All Balanced Property Fund Index

- Funds will be classified as Balanced if ~~they are open ended and~~
- their holdings of either office, retail, industrial, or “others” property account for no more than 70% of their portfolio, and
  - they are diversified geographically so that no more than 70% of their portfolio is located in any one of the following regions: Central London (City, Mid-town and the West End), Inner London, Outer London, South East, South West, Eastern, East Midlands, West Midlands, Yorkshire & Humberside, North East, North West, Scotland, Wales, Northern Ireland, Offshore UK)

## Proposed Inclusion Criteria

Sub-index: MSCI/AREF UK All Balanced Property Fund Index

- Funds will be classified as Balanced<sup>1</sup> if -
- their holdings of either Office, Retail, Industrial, Residential, Hotel or Other property account for no more than 70% of their portfolio, and
  - they are diversified geographically so that no more than 70% of their portfolio is located in any one of the following regions: Central London (City, Mid-town and the West End), Inner London, Outer London, South East, South West, Eastern, East Midlands, West Midlands, Yorkshire & Humberside, North East, North West, Scotland, Wales, Northern Ireland, Offshore UK)

# MSCI/AREF UK Long Income Property Fund Index - Inclusion Criteria Change Proposal

- **Proposal:** Amendment to the inclusion criteria to exclude the requirement of diversified allocation
- As per proposed criteria, the long income funds index classification is based on maintaining,
  - Weighted Average Unexpired Lease Term greater than 15 years
  - Low leverage ratio (not more than 20%)
- **Rationale:** To align the definition of the sub-index with long income strategy rather than diversification strategy
- **Impact:** No impact to the index composition as there are no specialist funds with lease length greater than 15 years

## Existing Inclusion Criteria

Sub-index: MSCI/AREF UK Long Income Property Fund Index

Funds that maintain weighted average unexpired lease lengths of over 15 years as of December 2015 (this criterion is reviewed from time to time) qualify for inclusion in this sub-index. Low leverage and a diversified portfolio are further conditions for inclusion within this category

## Proposed Inclusion Criteria

Sub-index: MSCI/AREF UK Long Income<sup>2</sup> Property Fund Index

Funds will be classified as long income fund if they maintain,

- the weighted average unexpired lease term of greater than 15 years (based on prior quarter data provision)
- low leverage ratio i.e., not more than 20% (where leverage is defined as the ratio of total debt to the fund's GAV)

# Clarification on Treatment of funds closed for New Investment and Redemptions

## Proposal:

- In case a fund closes to new contributions or redemptions, its inclusion in the open-ended funds sample will be reviewed
- For example, funds in which dealings are suspended will be monitored for an observation period of four quarters. Fund shall remain included in the open-ended funds sample during the observation period.
- Sustained suspension status of the fund for the fourth consecutive quarter will result in exclusion of the fund from the open-ended funds sample.
- Suspended funds will continue to be a part of standard UK PFI Index / sub-index composition

## Rule 5

# Proposed re-wording of existing criteria (Clarification)

Rule #	Existing Inclusion Criteria	Amended text
5	Be open to new investors or <b>have the possibility in the near future for investment by new investors</b> . Funds such as joint ventures (the investors in which are expected to remain unchanged during the life of the fund) are, therefore, not eligible for inclusion.	<p>The fund must be open to investment by new investors i.e.,</p> <ol style="list-style-type: none"><li>i. fund registered as open-ended fund</li><li>ii. Semi open-ended fund where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life, during which either<ol style="list-style-type: none"><li>a) investors are not permitted to redeem their investment , or</li><li>b) redemptions by investors are restricted to a maximum fixed percentage of their investment in any one year</li></ol></li><li>iii. fund registered as closed-ended but open to additional investors after one or more additional closings and the final initial closing of the fund</li></ol> <p>Funds such as joint ventures (the investors in which are expected to remain unchanged during the life of the fund) are, therefore, not eligible for inclusion.</p>

# Discussion Points

1. Do you agree with the proposed minimum UK investment exposure?
2. Do you agree with the proposed requirement of quarterly performance measurement of direct property portfolio by MSCI?
3. Do you agree with the proposed threshold for minimum NAV requirement for index inclusion?
4. Do you agree with the minimum historical data provision requirement?
5. Do you agree with the proposal to align with Global Property Type Sector classification for MSCI/AREF UK All Balanced Property Fund Index?
6. Do you agree with the proposal to remove the requirement of diversified allocation from inclusion criteria for MSCI/AREF UK Long Income Property Fund Index?
7. Do you agree with the treatment of funds closed for new investment and redemptions?
8. Do you agree with the clarification provided to methodology by re-wording the existing criteria?

# Other Discussion Topics

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QUARTERLY REVIEW AND RECERTIFICATION OF  
INCLUSION CRITERIA

# Background

## Quarterly review and re-certification of inclusion criteria

- **Current Practice**

- Fund eligibility is assessed only at the point of initial inclusion
- No subsequent review inclusion criteria to assess eligibility for funds' retention within the UK PFI

- **Proposed Practice**

- Quarterly recertification by index constituents
- Quarterly review of balanced funds / long income funds sub-index inclusion criteria
  - Introduce observation period where intended strategy is unaltered from the original criteria requirement
- Exclusion of funds not meeting the inclusion criteria requirements outside observation period

- **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 quarterly Re-certification of Inclusion Criteria

- MSCI proposes to review the below criteria on a quarterly basis

Rule #	Criteria	Index name	Observation period
1	The fund should not be listed on a stock exchange	MSCI / AREF UK Quarterly Property Fund Index	n/a
3	The fund should have investment performance of its direct property portfolio measured by MSCI at least quarterly. The frequency of asset and fund data provision to MSCI must align with the valuation and reporting regime of the fund and must respect MSCI's data collection deadlines	MSCI / AREF UK Quarterly Property Fund Index	n/a
4	The fund must be a full member of the Association of Real Estate Funds (AREF)	MSCI / AREF UK Quarterly Property Fund Index	n/a
8	The fund must value and report the Net Asset Value (NAV) at least quarterly (preferably monthly)	MSCI / AREF UK Quarterly Property Fund Index	n/a
10	The fund's NAV should be based on the valuation of at least 95% of the value of its property portfolio; The valuation must also cover properties held through joint or indirect investments such as shares in listed property companies and derivatives	MSCI / AREF UK Quarterly Property Fund Index	n/a

# Proposed quarterly Re-certification (incl. Observation period)

Rule #	Criteria	Index name	Observation period	Appendix reference
2	The fund should have a minimum of 95% of their gross assets (excl. Cash) invested in the UK	MSCI / AREF UK Quarterly Property Fund Index	4 quarters	
6	The fund must have a NAV equal to or greater than GBP 100m	MSCI / AREF UK Quarterly Property Fund Index	4 quarters	<a href="#">Appendix 1</a>
	Funds will be classified as long income fund if they maintain, <ul style="list-style-type: none"> <li>i. the weighted average unexpired lease term of greater than 15 years (based on prior quarter data provision)</li> <li>ii. Low leverage ratio i.e., not more than 20% (where leverage is defined as the ratio of total debt to the fund's GAV)</li> </ul>	MSCI/AREF UK Long Income Property Fund Index	4 quarters	<a href="#">Appendix 2A</a>
	Funds will be classified as Balanced if, <ul style="list-style-type: none"> <li>i. their holdings of either office, retail, industrial or "other" property account for no more than 70% of their portfolio, and</li> <li>ii. they are diversified geographically so that no more than 70% of their portfolio is located in any one of the following regions: Central London (City, Mid-town and the West End), Inner London, Outer London, South East, South West, Eastern, East Midlands, West Midlands, Yorkshire &amp; Humberside, North East, North West, Scotland, Wales, Northern Ireland, Offshore UK)</li> </ul>	MSCI/AREF UK All Balanced Property Fund Index	4 quarters	<a href="#">Appendix 2B, 2C</a>

# Proposed quarterly Re-certification | New Sub-Index Criteria

#	Criteria	Index name	Observation period
New Sub-index criteria	Funds will be classified as open-ended if, i. fund registered as open-ended fund ii. Semi open-ended fund where investors may be subject to an initial “lock up” for the first 3 to 5 years of the life, during which either 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	Proposed Open-ended funds sub-index	n/a

# 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 funds to criteria for fourth consecutive quarter will qualify for exclusion from the index

## **Potential benefits of Quarterly Review and Observation Period:**

- Allow for index stability in case of a temporary non-adherence to classification criteria
- Ensure consistent sub-index composition
- Rules based index composition and governance

# Discussion Points – Quarterly Review and Observation Period

1. Do you agree with the rule-based approach to perform quarterly review and recertification?
2. Do you agree with the identified list of criteria that is under the scope of quarterly review and recertification?
3. Do you agree with the observation period of four quarters?
4. Do you agree with the list of criteria for which observation period would be applicable?

# Changes to Product offering

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INTRODUCE OPEN-ENDED SUB-INDEX

DISCONTINUE LOW-GEARED BALANCED SUB-INDEX

# Changes to Product Offering

- MSCI intends to introduce open-ended funds sub-index series in order to ensure a like-for-like comparability for the open-ended funds in the index
  - 33 of 45 funds in the UK PFI are open-ended funds
  - 87.6% of the NAV of UK PFI is comprised of the open-ended funds sample
  - Refer [Appendix 3A.3B](#) for additional analysis
  
- MSCI intends to discontinue publishing the Low-Geared Balanced Property fund index
  - The composition of low geared balanced sub-index and all balanced sub-index is the same since 2014
  - Largely there is no performance divergence between low-geared funds and Balanced funds from 2014 onwards
  - Between 2000 and 2013, there are differences in returns between UK Low Geared Balanced Property Fund Index and UK All Balanced Property Fund Index
  - Refer [Appendix 3C.3D](#) for additional analysis

# Appendix 1

## MINIMUM NAV CRITERIA

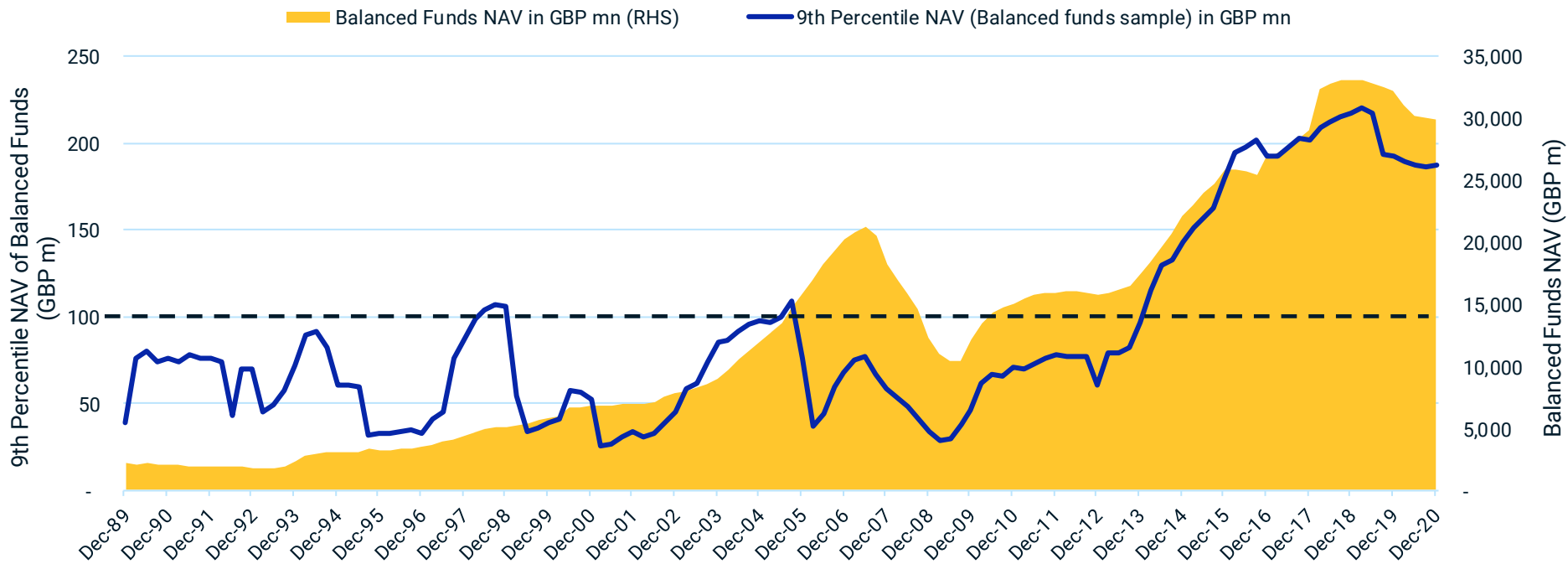
[Inclusion Criteria  
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Offering](#)

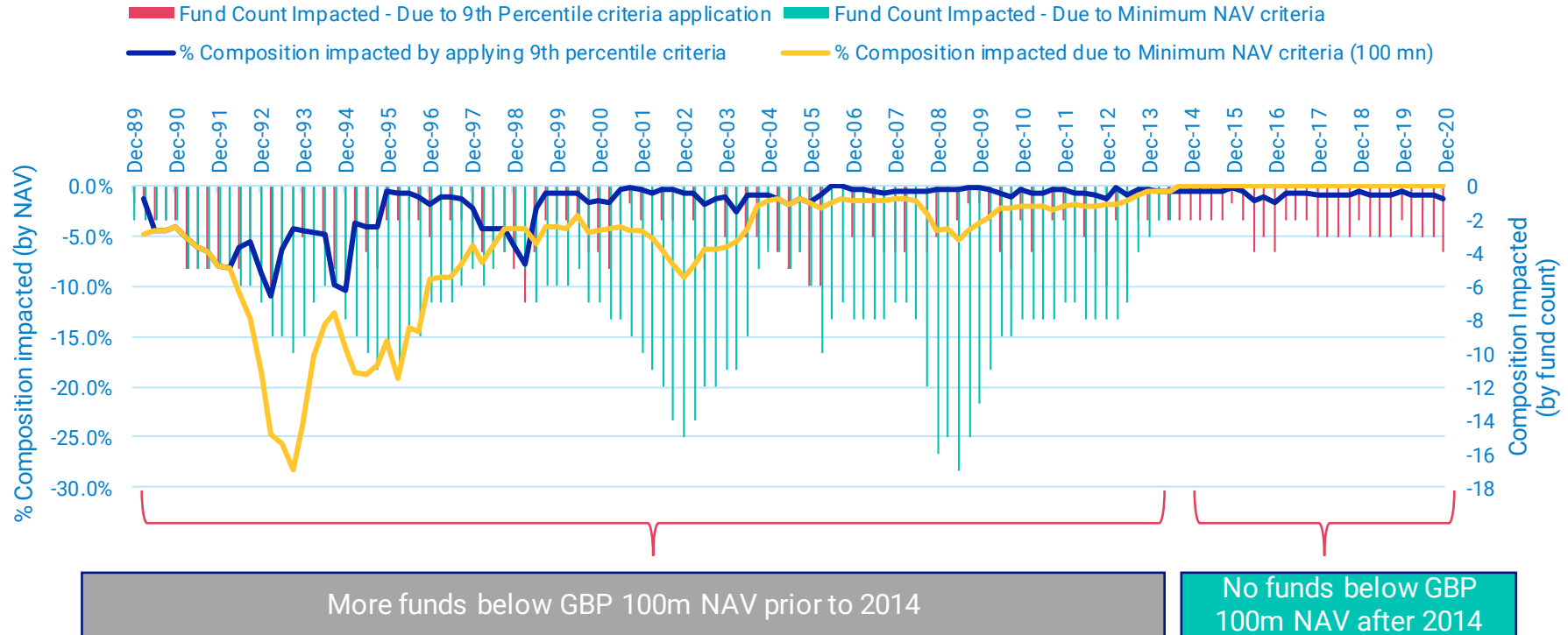


# Appendix 1A: NAV 9<sup>th</sup> Percentile of Balanced funds sub-index

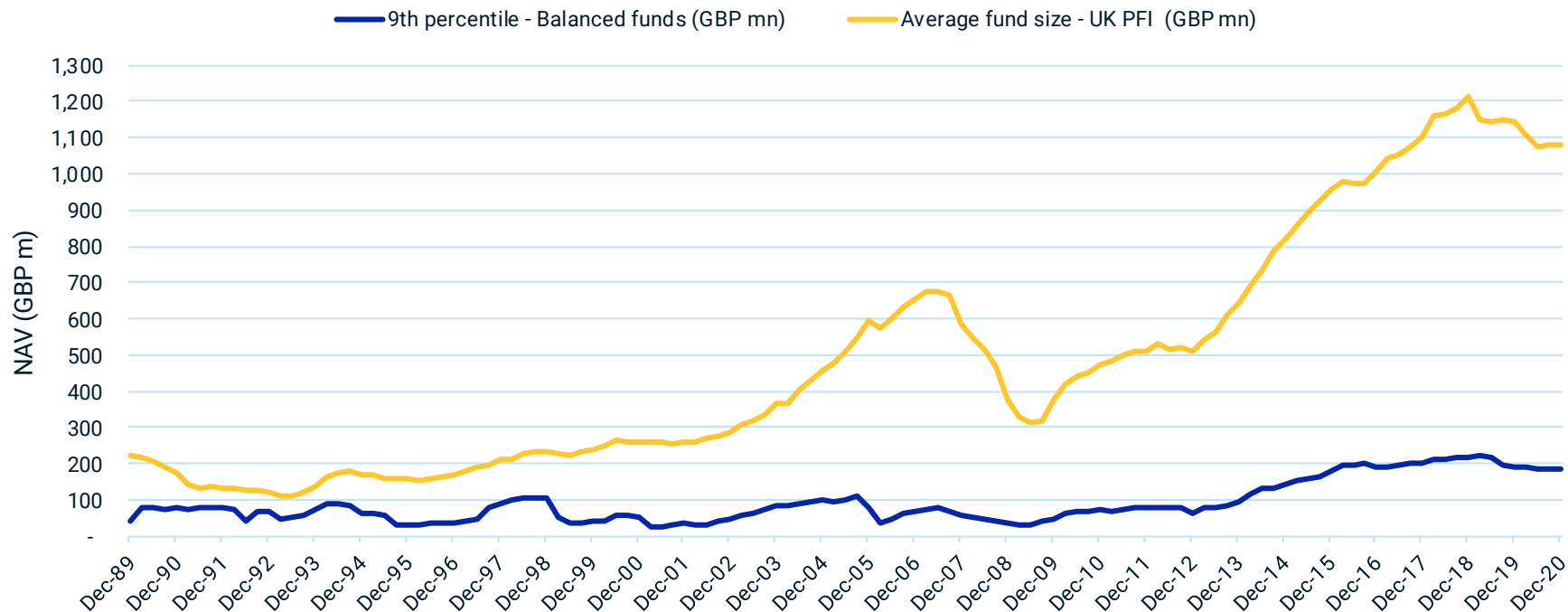


# Appendix 1B: Impact due to retention of Minimum NAV criteria

Criteria based on 9<sup>th</sup> percentile and minimum NAV = GBP 100m



# Appendix 1C: UK PFI - Average fund size vs. 9<sup>th</sup> Percentile threshold



# Appendix 2

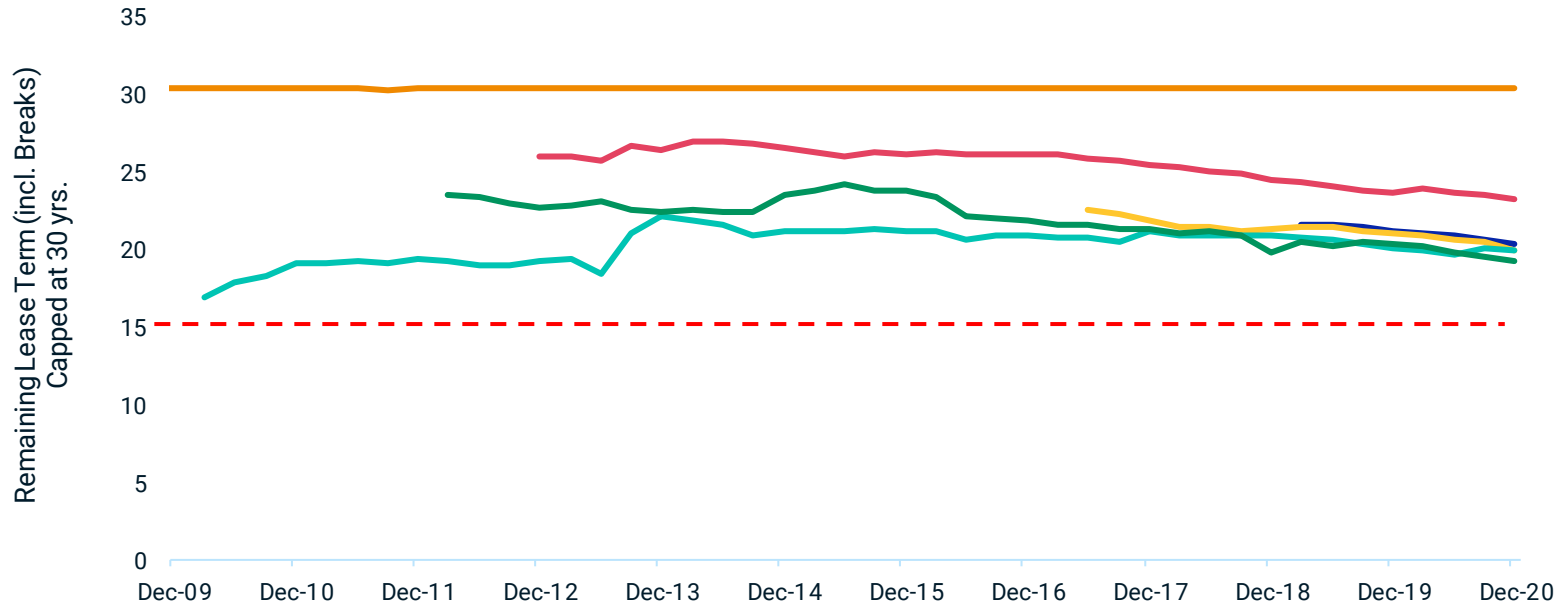
## OTHER DISCUSSION TOPICS

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[Other Discussion  
Topics](#)

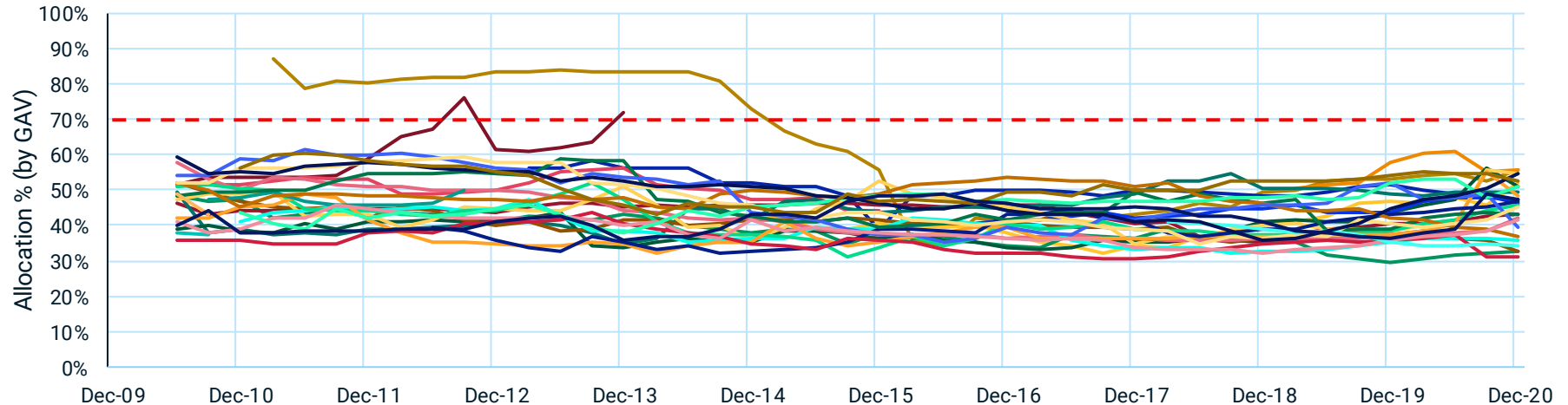
[Changes to Product  
Offering](#)

# Appendix 2A: Long Income funds > 15yrs Remaining lease term

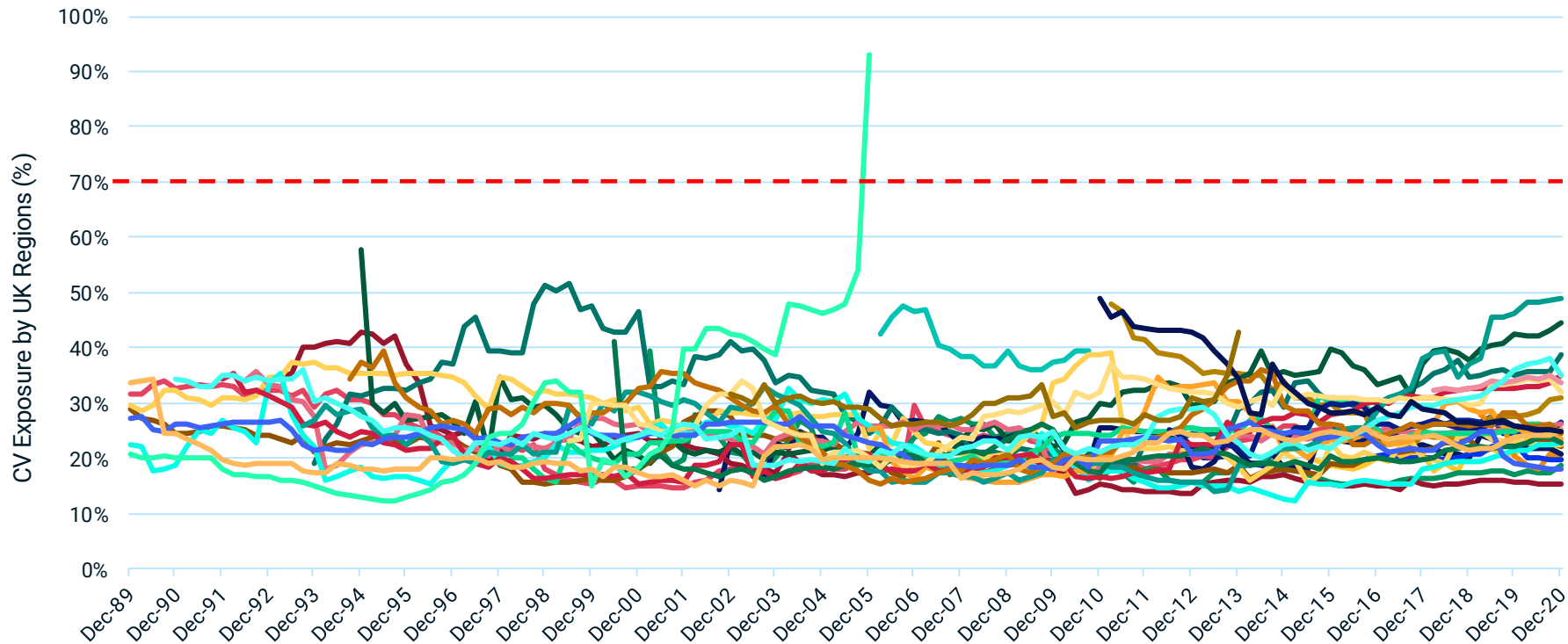


## Appendix 2B: Balanced funds < 70% single sector exposure

- Each point in the line chart below represent a portfolio with its maximum exposure to a single sector at each period
- Two portfolios in the history during Sep-2012 and Dec-2014, respectively, exceeded the 70% sector exposure limit
- If included prior to 2014, one fund would have been classified as specialist fund but switching strategy to balanced from Dec 2015 onwards >> less than 70% exposure would have been maintained at end of observation period
- However, as per data provision, this fund has always remained a balanced fund since its inclusion in the index (after 2014)

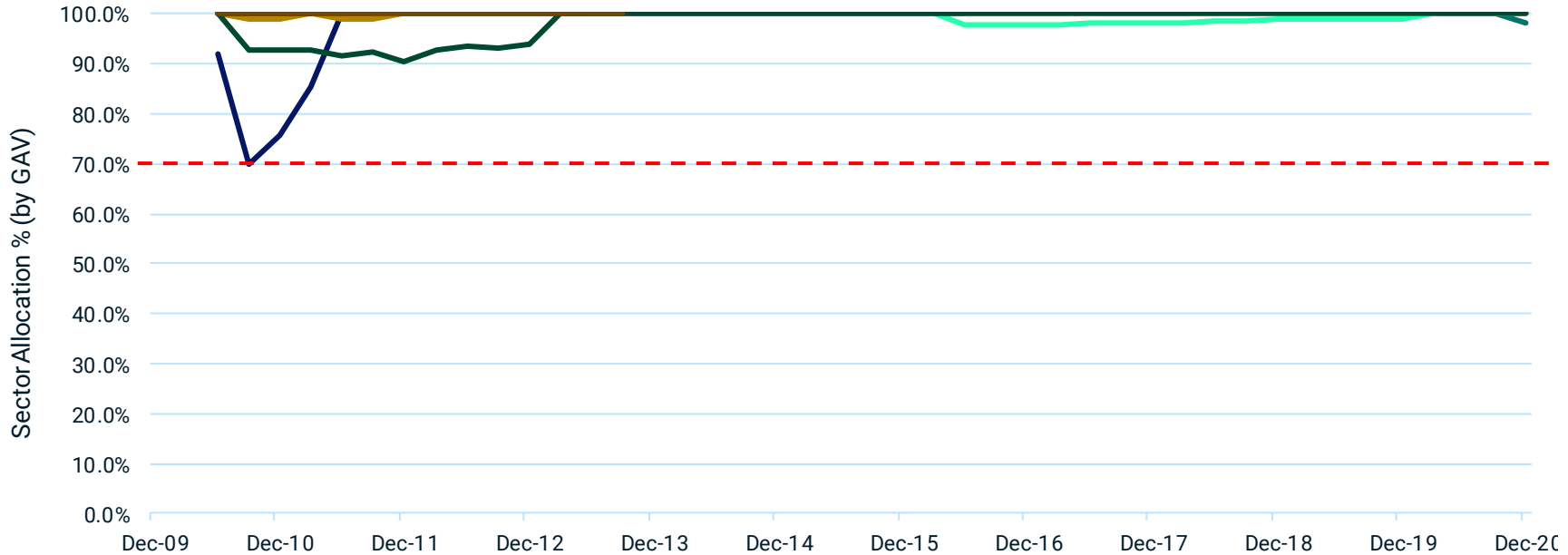


## Appendix 2C: Balanced funds < 70% single UK region exposure



# Appendix 2D: Specialist Funds > 70% single sector exposure

No funds have recorded sector allocation below the 70% threshold





# Appendix 3

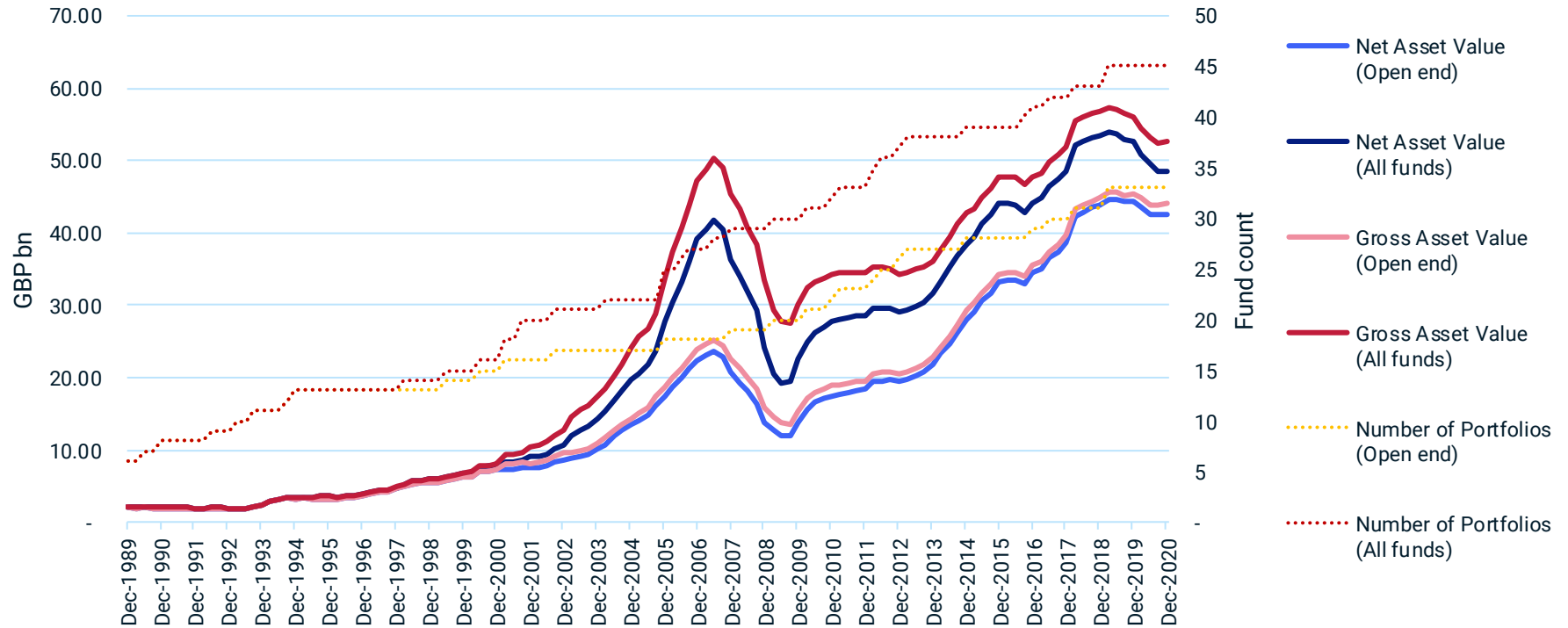
## CHANGES IN PRODUCT OFFERING

[Inclusion Criteria  
Change Proposal](#)

[Other Discussion  
Topics](#)

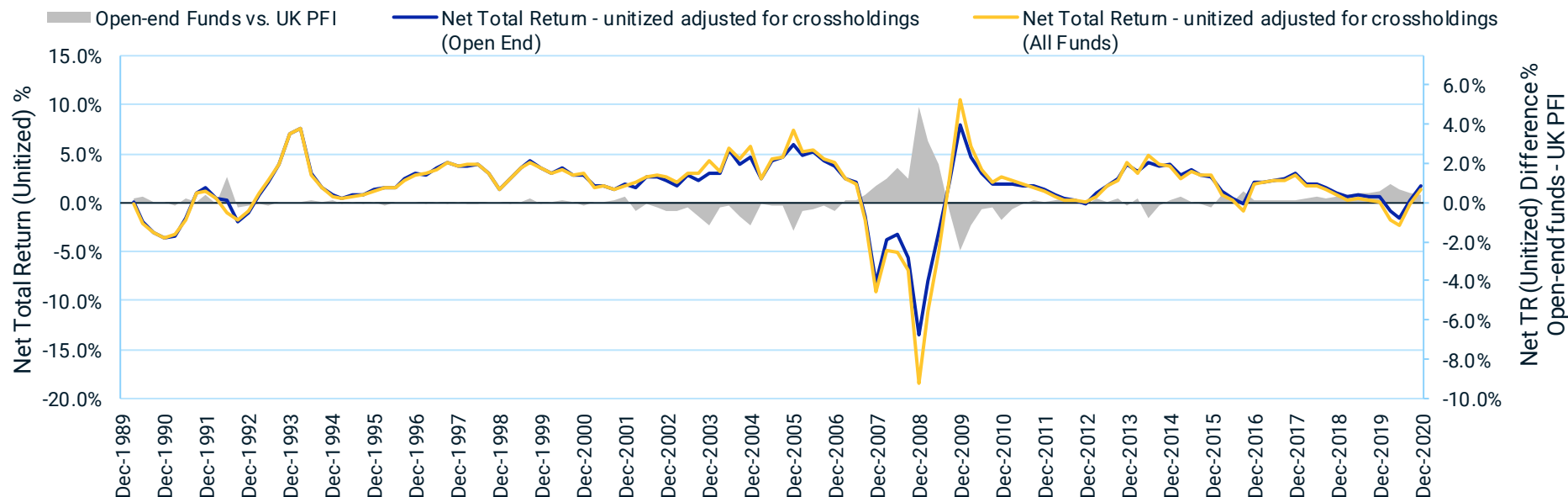
[Changes to Product  
Offering](#)

# Appendix 3A: Introduce Open-ended funds Sub-Index



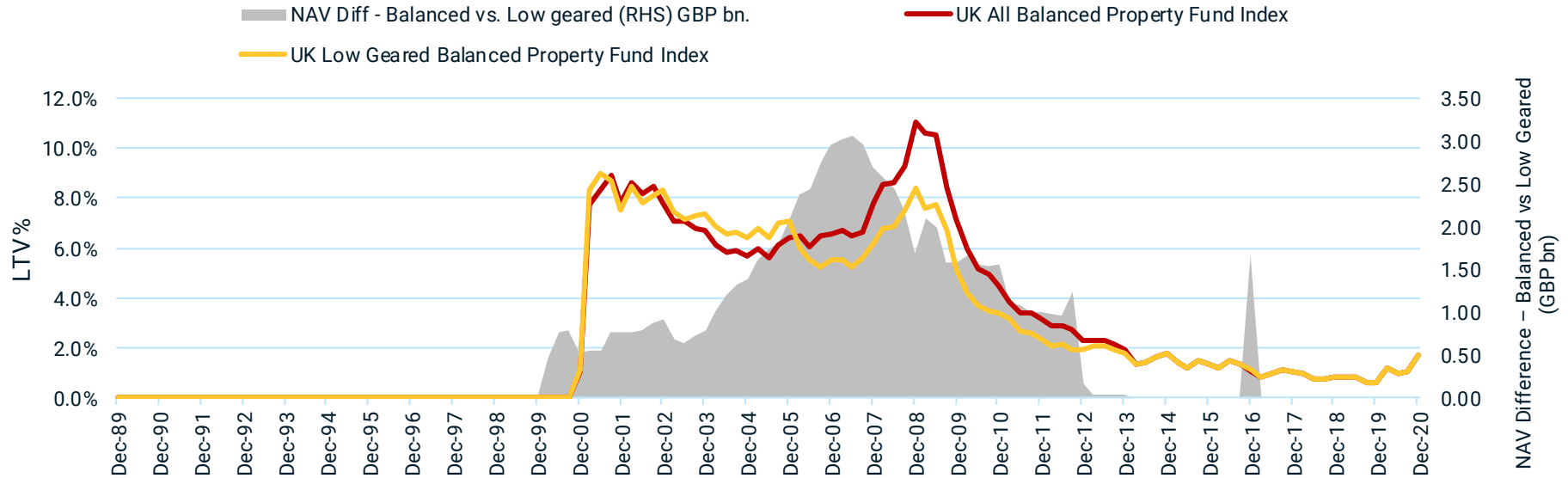
# Appendix 3B: Introduce Open-ended funds Sub-Index

- 33 out of 45 funds in UK PFI are open-ended funds
- Open end funds under-perform UK PFI in positive market & out-perform during adverse market performance
- This primarily driven by relative low leverage and divergence with specialist fund returns in the index that are closed-ended



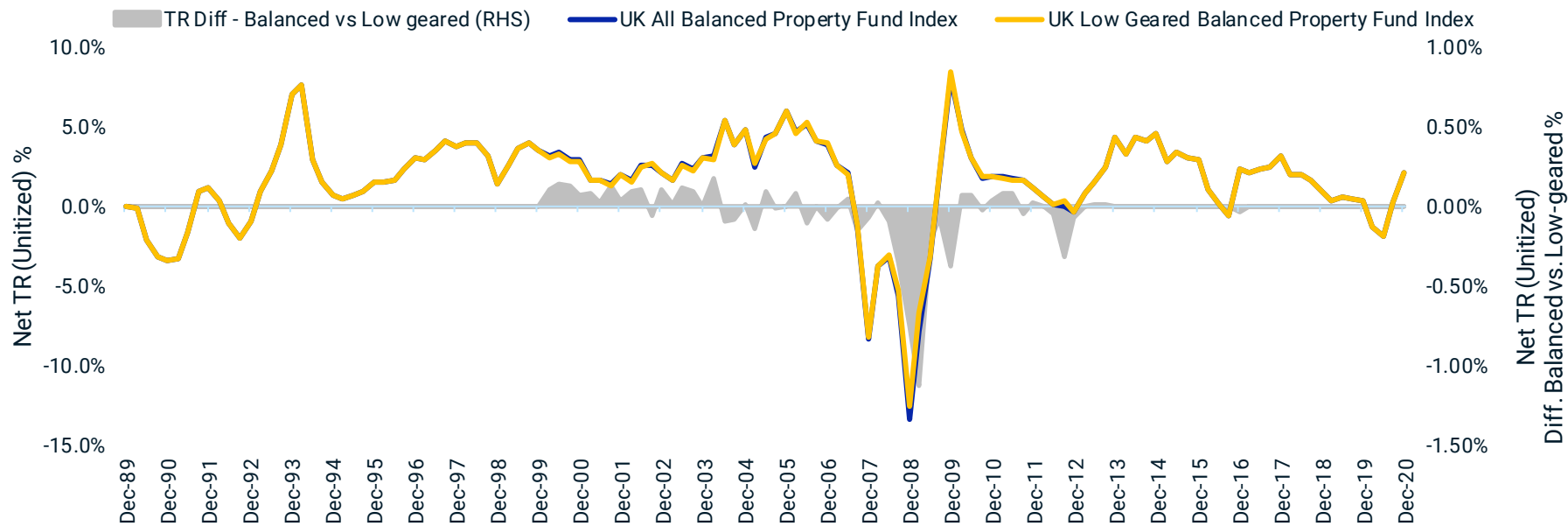
# Appendix 3C: Discontinue Low Geared Balanced Sub-Index

- The composition of low geared balanced sub-index and all balanced sub-index is the same since 2014



# Appendix 3D: Discontinue Low Geared Balanced Sub-Index

- No performance divergence between low-geared funds and Balanced funds from 2014 onwards
  - Between 2000 and 2013, there are differences in returns between UK Low Geared Balanced Property Fund Index and UK All Balance d Property Fund Index



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