AREF

# Guidance on Expense Ratios

**Principles, Basis of Calculation & Presentation**

**Effective from 1st January 2009**

**Code of Practice Sub-Committee**

**February 2009**

## Background

*Status of Guidance*

- AREF has consulted members twice on the issue of expense ratios: first in late 2007, and secondly during November 2008. Feedback was considered by the Code of Practice Sub-Committee and its recommendations were approved unanimously by the AREF Management Committee on 9th December 2008 for application by member funds for periods ending on or after 1st January 2009.

- This guidance will be included within the published Code of Practice in due course. In the meantime, this document will be published on the AREF website for members to view.

- The Code of Practice Sub-Committee will review the application of the guidance at the end of 2009, and where member funds believe further clarity is required on particular issues, feedback should be directed to Sarah Bryson (sbryson@aref.org.uk). For information, the members of the Sub-Committee are set out in the table below.

| | |
|---|---|
| Chris Mathew | Hermes |
| Emily Mousley | Hermes |
| Andrew Dewhirst | ING |
| Stafford Biddulph | Rockspring |
| Deborah Lloyd | Nabarro |
| Ludo Mackenzie | Henderson |
| Fiona Rowley | PRUPIM |
| Gawain Hughes | CMS Cameron McKenna |

*Application*

- The guidance applies to all AREF member funds and publication of fee metrics will be a requirement of the Code of Practice in 2009. Some members of AREF are authorised funds, and these must follow FSA rules on the preparation of expense ratios. For real estate funds the rules have been interpreted by the IMA, and for authorised funds the FSA's requirements take priority over the framework set out in this paper.

- In some cases application of some parts of the framework set out in this paper may prove difficult for some funds as there is unlikely to be a 'one size fits all' solution given the diverse nature of the AREF membership and different manager approaches to the calibration of fees. Where there is doubt over the allocation of costs that are material, member funds should make decisions based on the clarity and transparency for the users of the information, and make disclosures as appropriate to help users of the information understand the rationale for the particular allocation decision.

*Approach*

- This paper reflects three core requirements as follows.

1. **Consistency**
   - Between asset classes so that a real estate Total Expense Ratio (TER) is comparable with those published in other asset classes.
   - Between real estate funds using this framework, the guidance must be robust in order to ensure consistency in application.
   - With other industry guidance (IMA & INREV) but reflecting points of difference that may be appropriate for AREF member funds.

2. **Transparency** – that the wider metrics provide transparency on the costs of running a fund and appropriate definition is provided on items that may be material, such as transaction costs and performance fees. Ideally these should be viewed separately from the '*steady state*' costs of running a fund.

3. **Relevance** – the metrics and supporting guidance must be relevant and useful for both end-user and also importantly, it must be clear and simple to apply for those preparing the metrics for member funds.

*Points of difference with INREV & IMA*

- There are a few small differences between the guidance set out in this paper and the guidance published by INREV and the IMA. These are noted in the table below together with the reason for any departure.

| Point of difference | IMA | INREV |
|---|---|---|
| **Synthetic ratios** - this is where a fund, which itself invests in other funds, pulls the ratios from the underlying funds into its own ratio. | Authorised funds are required to calculate a synthetic ratio, but for 2009 this is considered impractical for AREF members particularly as many will be calculating expense ratios for the first time. This position will be reviewed in 2010. | AREF consistent with INREV in 2009. |
| **Performance fees** | For authorised funds performance fees are included in the Total Expense Ratio, whereas in this guidance these are noted as a separate item. | AREF consistent with INREV. |
| **Capitalised costs (for example head / ground rents)** – Certain costs will be deducted by valuers in arriving at a valuation, for example the rent paid by the owner of a long lease to a freeholder. | The IMA guidance specifically includes ground rents in the calculation of the Property Expense Ratio, whereas the AREF Sub-Committee believes that capitalised costs of this nature should be excluded. Further discussion is being held between AREF and the IMA with a view to bringing the two approaches into line. | AREF consistent with INREV. |
| **Transaction costs** | The IMA guidance excludes transaction costs from its calculations, but provides for disclosure of costs in financial statements. | INREV includes these costs within 'Property-specific Costs.' The sub-committee believes that this approach may be misleading when the fund is growing or |

| | | |
|---|---|---|
| | In the AREF guidance, transaction costs are identified as a separate item within the cost metrics. Including transaction costs ensures consistency with INREV (subject to a change in presentation) and provides end-users with greater transparency. | shrinking through transactional activity and that these costs should therefore be stated separately. This would allow investors to see a 'steady state' position for the fund. |
| **Basis of calculation NAV / GAV** | IMA guidance provides that the calculation is based on NAV only. The AREF guidance allows for calculation based on a GAV measure also. | AREF is consistent with INREV. |

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## Approved Framework

This section sets out the framework for AREF's expense ratios with worked examples attached as annexes as follows.

- Annex 1 – this provides a schedule of the costs in each category and compares this with the INREV methodology.
- Annex 2 - provides a worked example of a portfolio over a 12 month period reflecting transactions, fees paid to the manager and third parties, creation of units and gearing.
- Annex 3 – this breaks the costs into the various fee metrics using the proposed AREF approach using a NAV approach together with a comparison with INREV.
- Annex 4 – using the example in Annex 3, this shows the calculation on a GAV basis.

Commentary on the methodology is set out below.

- **Total Expense Ratio (TER)** – this captures all fund management and fund operating costs necessary for the proper operation of the fund, together with fund level asset management fees. The fund management functions cover all those high level, directional / approval / monitoring functions that essentially sit at head office, and the fund operating costs capture a range of items from audit and valuer fees through to promotion of the fund to new and existing investors. Fees may be capital or revenue in nature.

  The TER should **not** include asset management costs that are property specific (such as rent reviews, lease renewals, letting costs etc), but should instead cover arrangements that relate to 'fund level' asset management for example preparation of annual property / business plans as part of a fund level exercise, or work on sustainability at fund level. This should put funds that charge an 'all in' fee on an equal footing to those that charge separately or externalise their asset management.

  The TER includes all non-performance fees paid to the manager (whether revenue or capital in nature) where these are over and above fees charged to third parties where these third party costs are carried in other expense ratios. Manager performance fees are carried as a separate cost item. Examples of fees paid to the manager would be fees derived from transactions, and fees paid to the manager for strategic management, monitoring and oversight functions where these are in addition to the fees charged by the third party.

  The rationale for the inclusion of these costs within the TER is to ensure consistency between funds given different manager approaches to the calibration of fund management charges. Otherwise a manager charging a 1% per annum fee (of NAV) for 'all in' costs, would have a very different TER to a manager that charged a 0.5% per annum fee, but then charged separately for other activity within the fund which would otherwise be carried in other ratios.

  To ensure consistency with the INREV proposals, the TER should be subdivided into 'Fund Management Fees' and 'Fund Operating Expenses' and these items noted separately.

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- **Property Expense Ratio (PER)** – this captures all non-recoverable revenue costs associated with the management and operation of the property portfolio itself including day-to-day property management and rent collection.  A more detailed breakdown of the costs are set out in the table below.

  Costs of a capital nature should be excluded and so transaction fees and costs and items such as development fees should be excluded.  The rationale for excluding (for example) development expenditure or expenditure on improvements is that the cost should (not always) result in an increase in asset value, whereas the spend on day-to-day maintenance and repairs is unlikely to be reflected in the value of the property.

- **Transaction Costs** – expressed as a separate item.  These may be material at fund level and should therefore be identified separately to enable investors to see the 'steady state' costs associated with the operation of the fund without distortion at times of high transactional activity.  Additionally the fund is required to publish a Portfolio Turnover Ratio, which indicates how much of the turnover in the portfolio has been driven by investment and withdrawals from the Fund.  This is known as a 'Portfolio Turnover Ratio' and the FSA use this measure for authorised funds to put alongside the wider cost metrics.  Amounts used in the calculations are on a gross basis.

$$\text{Portfolio Turnover Ratio} = \frac{\text{(Purchases + sales)} - \text{(new issues + redemptions)}}{\text{Average NAV}}$$

The ratio puts some context against the transaction costs carried by the fund.  For example a fund that has incurred a high level of transaction costs may have done so in order to either buy assets on behalf of new investors, or sell assets to facilitate exit of existing investors.  As the ratio nets out these investor flows, it illustrates the turnover / churn in the underlying portfolio.  For example a £100 million fund with purchases of £25m and sales of £25m, driven by new investment of £25m and redemptions of £25m, this would have a Portfolio Turnover Ratio of 0%.  Whereas for a fund that had no new or redeeming investors, the same ratio would be 50%.

- **Performance Fee** – expressed as a separate item.

## Summary of cost metrics

| Expense Ratio | Items Captured |
|---|---|
| **(A) Fund Management Fees** | Fund management fees, to include core functions such as fund accounting, reporting, investor relations.<br><br>Investment management fees (for approvals, oversight, direction, reviewing etc).<br><br>Fund level asset management arrangements (not project specific costs which are carried in (D)).<br><br>Other fees paid to manager associated with investment management function – for example, transactions, development oversight, debt |

| | |
|---|---|
| | management – and transaction fees paid to Manager. |
| **(B) Fund Operating Expenses** | Non-property specific costs, including:<br>- Supervisory board<br>- Administration fees<br>- Audit fees<br>- Valuer fees<br>- Custody / Trustee fees<br>- Fund legal fees<br>- Fund marketing fees<br>- Other fund level professional fees<br>- Company secretarial fees<br>- Taxes (not relating to transactions) such as non-recoverable VAT associated with the operations of the fund.<br>- Miscellaneous fees and expenses associated with the operation of the fund.<br>- Amortised set up costs (where expensed)<br>- Amortised debt costs<br>- other costs associated with debt such as valuation fees (but not debt interest which is excluded)<br>[In all cases the allocation of costs should follow the accounting treatment]. |
| ***(C) Total Expense Ratio (TER)*** | *The aggregate of Fund Management Fees and Fund Operating Expenses (A + B)* |
| **(D) Property Expense Ratio (PER)** | **Property portfolio specific costs including:**<br>- Service charge shortfalls and holding costs such as empty rates and security<br>- Rent review and lease renewal costs<br>- Maintenance and repairs (not improvements)<br>- Property insurance costs / rebates<br>- Aborted transaction costs where appropriate. |
| ***(E) Real Estate Expense Ratio (REER)*** | *C + D*<br>*This represents the 'steady state' costs associated with the operation of the fund.* |
| **(F) Transaction costs** | Tax, professional fees and other costs associated with the purchase and sale of property holdings. |
| **(G) Performance fee** | Performance fees paid (or accrued for) to the manager during the period, whether of a capital or revenue nature. This should include any performance fees paid to third parties to the extent that the fee relates to strategic / fund level activities. If performance fees are paid to third parties for activities at asset level, then these should be carried within the Property Expense Ratio or in transaction costs as appropriate. |

**Notes to presentation & calculation**

- **NAV** - Reflecting the IMA's guidance, it is recommended that expense ratios are based on the average equity employed by the fund over the preceding period (usually 12 months) with the average net equity employed relating to the same period as the costs. The accounting NAV should be adopted. This would represent minimum compliance.

- **GAV** - AREF member funds may also (this is optional) publish expense ratios based on the Gross Asset Value (GAV) of the fund. The definition of NAV is the total value of all assets (including direct and indirect holdings and cash, net of expenses) and liabilities. GAV is derived from the addition of the NAV and the fund's debt or gearing. For example, the GAV for a fund with an NAV of £100m and with total debt of £100m, would be £200m. There are limitations to the calculation of expense ratios on a GAV basis, where the numerator is unchanged from the NAV approach, but the denominator is simply increased in value. This is accepted.

- **Subsidiaries** – where the fund holds 50% or more or has control in an investment, the costs from these investments should be carried into the fund's expense ratios. This not a synthetic ratio (see below).

- **Synthetic Ratios** – For 2009 no synthetic ratio is calculated, but the Sub-Committee will review this position for 2010. Despite this not being in accordance with the IMA guidance, for AREF members this represents the most practical / workable position. For funds-of-funds, the ratio reported would be that of the vehicle wrapper and not a ratio based on those of the underlying funds. The fund-of-funds should disclose that the ratios have been prepared on this basis and that the ratio does not reflect the costs embedded in the investments.

- **Capitalised costs** – The Sub-Committee's recommendation is that capitalised costs (those costs deducted by valuers in arriving at their valuation of a property holding) are excluded from the Property Expense Ratio. This would be a specific departure from the IMA guidance, and the Sub-Committee will continue to discuss this issue with the IMA for a change in their guidance.

- **Payable / due** – All cost data should be based on accrued amounts consistent with the approach taken in periodic financial statements.

- **Reporting formats** – to provide consistency in reporting, AREF recommends that fee metrics are presented in formats similar to that set out in the table overleaf. Managers may wish to present ratios from previous periods for comparison. The requirements are effective from start-2009 and minimum compliance is to publish ratios in Annual and half yearly accounts (if produced), but best practice would be to provide this information in periodic publications and/or a fund prospectus as appropriate.

| Item | % of NAV per annum | Disclosure requirement |
| --- | --- | --- |
| (A) Fund Management Fees | | Minimum Compliance for NAV, optional for GAV. |
| (B) Fund Operating Expenses | | Minimum Compliance for NAV, optional for GAV. |
| **(C) Total Expense Ratio (TER) (A+B)** | | **Minimum Compliance for NAV, optional for GAV** |
| (D) Property Expense Ratio (PER) (excludes items in TER) | | Minimum Compliance for NAV, optional for GAV. |
| **(E) Real Estate Expense Ratio (REER) (TER + PER)** | | **Minimum Compliance for NAV, optional for GAV** |
| (F) Transaction Costs | | Minimum Compliance for NAV, optional for GAV. |
| (G) Performance Fees | | Minimum Compliance for NAV, optional for GAV. |

The Portfolio Turnover Ratio should be noted alongside the ratios, together with any supporting commentary the manager believes is appropriate.

- **Additional disclosures** – where a member fund believes that additional disclosures will provide more relevant information to investors, this would be encouraged by AREF.

- **Periods for reporting** - generally the quoted ratio should be on a 12 month basis reflecting the costs incurred by the fund over a 12 month period. If a member fund departs from this approach, (for example if the fund has not been established for 12 months) then the reasons for a departure must be disclosed.

- **Audit** – AREF will review each fund's compliance on a rolling basis as part of their checks to ensure funds are in compliance with the Code of Practice.

- **Authorised funds** – for authorised funds it should be noted that where the AREF guidance conflicts with the IMA guidance, that funds should follow the IMA guidance.

- **TER** – Specific exclusions – this follows the IMA guidance with costs excluded from the Total Expense Ratio being:

  1. Costs included in the Property Expense Ratio
  2. Property acquisition and disposal costs (including transfer taxes), unless paid to manager
  3. Property development fees – unless paid to manager for oversight
  4. Project management fees – unless paid to manager for oversight
  5. Service charges and other costs that are recoverable from tenants
  6. Debt interest

**Code of Practice Sub-Committee – February 2009**

**Annex 1**

Cross-reference between INREV guidance and AREF proposals

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## Expense ratio definitions - comparison of AREF v InREV classifications

| Ratio | AREF | InREV |
|---|---|---|
| **Management fees** (A) | - Fund management fees, to include core functions such as fund accounting, reporting, investor relations<br><br>- Investment management fees (for approvals, oversight, direction, reviewing etc – not day-to-day property management)<br><br>- Other fees paid to manager associated with investment management function – for example, transactions, development oversight, debt management – and transaction fees paid to Manager | - Acquisition fees paid to manager<br>- Asset management fees<br>- Commitment fee<br>- Debt arrangement fee paid to manager<br>- Disposal fees paid to manager<br>- Fund management fees<br>- Project management fees (strategic management advice)<br>- Property advisor fees<br>- Related investment project cost |
| **Fund expenses** (B) | Non-property specific costs including:<br>- Administration fees<br>- Audit fees<br>- Valuer fees<br>- Custody / Trustee fees<br>- Fund legal fees<br>- Fund marketing fees<br>- Other fund level professional fees<br>- Company secretarial fees<br>- Taxes (not relating to transactions)<br>- Miscellaneous fees and expenses (operating)<br>- Amortised set up costs (where expensed) | - Administration fees<br>- Audit fees<br>- Valuation fees<br>- Custodian fees<br>- Legal fees (not property specific)<br>- Marketing fees<br>- Professional fees<br>- Regulatory/Statutory/Secretarial fees<br>- Taxes (excluding capital related) †<br>- Other/Miscellaneous/Sundry expenses<br>- Amortisation of formation expenses<br>- Printing and publication fees<br>- Trustee fees<br>- Set up fee<br>- Distribution fees<br>- Directors expenses and fees<br>- Depository fees<br>- Wind up fees<br>- Bank charges |
| **Total expense ratio** (C) | (A + B) | (A + B) |
| **Property expenses** (D) **(and ratio)** | Property portfolio specific costs including:<br>- Non-recoverable property management fees<br>- Service charge shortfalls and holding costs such as empty rates and security<br>- Rent review and lease renewal costs<br>- Maintenance and repairs (not improvements)<br>- Property insurance costs / rebates<br><br>- Amortised debt financing fees / costs<br>- Debt valuation fees<br><br>- Marketing of vacant space<br>- Project management fees (where not capitalised) | - Property management fees<br>- Service charges shortfall<br><br>- Letting and lease renewal fees<br><br>- Property insurance<br>- Acquisition/disposal related costs<br>- Debt financing fees<br>- Debt valuation fees<br>- Development fee<br>- Marketing of vacant space<br>- Project management fees - development<br>- Taxes on properties (exl transfer taxes not embedded in NAV) ‡ |
| **Real Estate expense ratio** (E) | (C + D) | (C + D) |
| **Transaction costs** (F) | - Tax, professional fees and other costs associated with the purchase and sale of property holdings, including aborted transaction costs. | |
| **Performance fees** (G) [F - InREV] | - Performance fees paid (or accrued for) to the manager during the period, whether of a capital or revenue nature. | - Performance fees<br>- Carried interest<br>- Tax leakage within the corporate structure † |

**Annex 2**
Worked example

## Step 1 - Transactions in analysed year

| | NAV at 31 Dec 2007 | 35 net units issued at offer price (spread 7.5%) on 1 Jan 2008 | Purchase property B completed on 1 Jan 2008 | Purchase property C completed on 1 Jan 2008 | Refurbishment of un-let space in Property C in Mar 2008 with void until letting in Nov 2008 | Revaluation of property portfolio at 31 Dec 2008 | Receipt of rental income less non-recoverable property costs (cash) | Payment of bank debt interest at fixed rate of 4% | Payment of fund operating overheads and tax | Provision of Fund Manager's fee at 0.75% of gross property value at y/end and performance fee | Total net distribution payable for the year ended 31 Dec 2008 | Revenue Account and Closing NAV for/at year ended 31 Dec 2008 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Cash | Cash | Cash | Cash | Cash | Cash | Cash | Cash | Accrued | Accrued | |
| **Revenue account** | | | | | | | | | | | | |
| Net rental income | | | | | | | 13,000,000 | | | | | 13,000,000 |
| Repairs and maintenance | | | | | (25,000) | | (45,000) | | | | | (70,000) |
| Empty rates and service charge shortfall | | | | | (200,000) | | (55,000) | | | | | (255,000) |
| Letting fees | | | | | (40,000) | | (100,000) | | | | | (140,000) |
| Other non-recoverable property expenditure | | | | | | | (300,000) | | | | | (300,000) |
| Bank interest payable on "gearing" [1] | | | | | | | | (3,600,000) | | | | (3,600,000) |
| Amortised debt set up costs | | | | | | | | | (100,000) | | | (100,000) |
| Fund Manager's base fee | | | | | | | | | | (1,537,500) | | (1,537,500) |
| Fund Manager's performance fee [2] | | | | | | | | | | (200,000) | | (200,000) |
| Valuation fees | | | | | | | | | (100,000) | | | (100,000) |
| Corporate costs | | | | | | | | | (400,000) | | | (400,000) |
| Tax | | | | | | | | | (200,000) | | | (200,000) |
| Net revenue available for distribution | | | | | (265,000) | | 12,500,000 | (3,600,000) | (800,000) | (1,737,500) | 0 | 6,097,500 |
| Distribution payable | | | | | | | | | | | (6,097,500) | (6,097,500) |
| Retained revenue | | | | | £(265,000) | | £12,500,000 | £(3,600,000) | £(800,000) | £(1,737,500) | £(6,097,500) | £0 |
| **Balance Sheet** | | | | | | | | | | | | |
| Direct property A | 100,000,000 | | | | | 6,000,000 | | | | | | 106,000,000 |
| Direct property B | | | 50,500,000 | | | 2,500,000 | | | | | | 53,000,000 |
| Direct property C | | | | 40,800,000 | 4,100,000 | 1,100,000 | | | | | | 46,000,000 |
| Gearing | (50,000,000) | | (20,000,000) | (20,000,000) | | | | | | | | (90,000,000) |
| Cash | 15,000,000 | 37,625,000 | (30,500,000) | (20,800,000) | (4,365,000) | | 12,500,000 | (3,600,000) | (800,000) | | | 5,060,000 |
| Accruals | | | | | | | | | | (1,737,500) | | (1,737,500) |
| Distribution payable | | | | | | | | | | | (6,097,500) | (6,097,500) |
| NAV | £65,000,000 | £37,625,000 | £0 | £0 | £(265,000) | £9,600,000 | £12,500,000 | £(3,600,000) | £(800,000) | £(1,737,500) | £(6,097,500) | £112,225,000 |
| Unitholders' contributions | 50,000,000 | 37,625,000 | | | | | | | | | | 87,625,000 |
| Unitholders' reserves | 15,000,000 | | | | | 9,600,000 | | | | | | 24,600,000 |
| Net revenue available for distribution | | | | | (265,000) | | 12,500,000 | (3,600,000) | (800,000) | (1,737,500) | (6,097,500) | 0 |
| Unitholders' interests | £65,000,000 | £37,625,000 | £0 | £0 | £(265,000) | £9,600,000 | £12,500,000 | £(3,600,000) | £(800,000) | £(1,737,500) | £(6,097,500) | £112,225,000 |

31 Dec 07 NAV = £65m therefore divided by 65 units = £1m per unit. With offer spread of 7.5%, offer price = £1.075m per unit

Being purchase price of £48m plus stamp duty and legals of £2m plus £0.5m transaction fee to Fund Manager

Being purchase price of £39m plus stamp duty and legals of £1m plus £0.8m transaction fee to third party

Fund Manager takes a fee of 2.5% of project cost (£100,000)

Notes
Ground rents - not shown within schedule as "pay-away" reflected in asset valuation.
[1] Bank interest payable on gearing includes undrawn commitment fees.
[2] Fund Manager performance fee (say 20% over 15% TR).

**Annex 3**

Attribution of costs into proposed framework (NAV basis) together with the INREV approach

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## Example PUT
## Step 2 - Summary of financial results for the year ended 31 December 2008

| | Year ended 31 Dec 2008 |
|---|---|
| **Revenue account** | |
| Net rental income | 13,000,000 |
| Repairs and maintenance | (70,000) |
| Empty rates and service charge shortfall | (255,000) |
| Letting fees | (140,000) |
| Other non-recoverable property expenditure | (300,000) |
| Bank interest payable on "gearing" | (3,600,000) |
| Amortised debt set up costs | (100,000) |
| Fund Manager's base fee | (1,537,500) |
| Fund Manager's performance fee | (200,000) |
| Valuation fees | (100,000) |
| Corporate costs | (400,000) |
| Tax | (200,000) |
| Distribution payable | £6,097,500 |

| | At 31 Dec 2007 | At 31 Dec 2008 |
|---|---|---|
| **Balance Sheet** | | |
| Direct property A | 100,000,000 | 106,000,000 |
| Direct property B | | 53,000,000 |
| Direct property C | | 46,000,000 |
| Gearing | (45,000,000) | (90,000,000) |
| Cash | 15,000,000 | 5,060,000 |
| Accruals | | (1,737,500) |
| Distribution payable | | (6,097,500) |
| NAV | £70,000,000 | £112,225,000 |
| | | |
| Unitholders' contributions | 50,000,000 | 87,625,000 |
| Unitholders' reserves | 15,000,000 | 24,600,000 |
| Unitholders' interests | £65,000,000 | £112,225,000 |
| | | |
| Number of units | 65 | 100 |
| NAV per unit | £1,000,000 | £1,122,250 |
| Offer price (spread 7.5%) | £1,075,000 | £1,206,419 |
| Income distribution per unit | | £60,975 |

### Performance (NAV to NAV per unit basis)

| | |
|---|---|
| Income return being £60,975 / £1,000,000 | 6.1% |
| Capital return being (£1,122,250 - £1,000,000) / £1,000,000 | 12.2% |
| Total return being (£60,975 + £1,122,250 - £1,000,000) / £1,000,000 | 18.3% |

## Example PUT
## Step 3 - Analysis of NAV total return and extraction of source numbers for REER
## (as defined by AREF with InREV calculation comparative)

| | Performance related values (absolute) | Performance related value per unit | Attribution of Total Return* | Performance attribution: Income less cost of gearing | Performance attribution: Expenditure | Performance attribution: Capital appreciation | Expense ratio source and disclosure values: Base fee | Transaction fee (Fund Manager) | Corporate costs | Corporate taxation | Valuation fees | Non-recoverable property costs | Transaction costs (3rd party) | Performance fees |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue Account** | | | | | | | | | | | | | | |
| Net rental income | 13,000,000 | 130,000 | 13.0% | 13.0% | | | | | | | | | | |
| Repairs and maintenance | (70,000) | (700) | -0.1% | | -0.1% | | | | | | | -0.1% | | |
| Empty rates and service charge shortfall | (255,000) | (2,550) | -0.3% | | -0.3% | | | | | | | -0.3% | | |
| Letting fees | (140,000) | (1,400) | -0.1% | | -0.1% | | | | | | | -0.1% | | |
| Other non-recoverable property expenditure | (300,000) | (3,000) | -0.3% | | -0.3% | | | | | | | -0.3% | | |
| Bank interest payable on "gearing" | (3,600,000) | (36,000) | -3.6% | -3.6% | | | | | | | | | | |
| Amortised debt set up costs | (100,000) | (1,000) | -0.1% | -0.1% | | | | | | | | | | |
| Fund Manager's base fee | (1,537,500) | (15,375) | -1.5% | | -1.5% | | -1.5% | | | | | | | |
| Fund Manager's performance fee | (200,000) | (2,000) | -0.2% | | -0.2% | | | | | | | | | -0.2% |
| Valuation fees | (100,000) | (1,000) | -0.1% | | -0.1% | | | | | | -0.1% | | | |
| Corporate costs | (400,000) | (4,000) | -0.4% | | -0.4% | | | | -0.4% | | | | | |
| Tax | (200,000) | (2,000) | -0.2% | | -0.2% | | | | | -0.2% | | | | |
| **Income return** | £6,097,500 | £60,975 | **6.1%** | | | | | | | | | | | |
| **Balance Sheet** | | | | | | | | | | | | | | |
| Direct property A (revaluation uplift being £106m - £100m) | 6,000,000 | 60,000 | 6.0% | | | 6.0% | | | | | | | | |
| Direct property B (revaluation uplift being £53m - £48m) | 5,000,000 | 50,000 | 5.0% | | | 5.0% | | | | | | | | |
| Direct property C (revaluation uplift being £46m - £4m - £39m) | 3,000,000 | 30,000 | 3.0% | | | 3.0% | | | | | | | | |
| Direct property B ("other" transaction fees being stamp duty/other legal £2m) | (2,000,000) | (20,000) | -2.0% | | -2.0% | | | | | | | | -2.0% | |
| Direct property B (transaction fees of £0.5m paid to Fund Manager) | (500,000) | (5,000) | -0.5% | | -0.5% | | | -0.5% | | | | | | |
| Direct property C ("other" transaction fees - stamp duty/other legal £1m and other £0.8m) | (1,800,000) | (18,000) | -1.8% | | -1.8% | | | | | | | | -1.8% | |
| Direct property C ("project" transaction fees paid to Fund Manager £0.1m) | (100,000) | (1,000) | -0.1% | | -0.1% | | | -0.1% | | | | | | |
| Spread on new units issued in period (£1,075,000 - £1,000,000 = £75,000 x 35 units = £2.625m) | 2,625,000 | 26,250 | 2.6% | | | 2.6% | | | | | | | | |
| **Capital return** | £12,225,000 | £122,250 | **12.2%** | | | | | | | | | | | |
| **Total return (and components thereof)** | | | **18.3%** | **9.3%** | **-7.6%** | **16.6%** | **-1.5%** | **-0.6%** | **-0.4%** | **-0.2%** | **-0.1%** | **-0.8%** | **-3.8%** | **-0.2%** |

Performance denominator (opening NAV per unit) £1,000,000

Note
- The above attribution is based on a "simple" total return calculation.
- In reality, quarterly returns would be calculated which would, when compounded, provide a rounding difference within the attribution analysis.

**AREF**

| (A) Fund Management Fees | (B) Fund Operating Expenses | (D) Property Expense Ratio | (F) Other tranaction costs | (G) Performance fees |
|---|---|---|---|---|
| -2.1% | -0.7% | -0.8% | -3.8% | -0.2% |

| (C) Total Expense Ratio ("TER") (A+B) | (E) Real Estate Expense Ratio ("REER") (C+D) | (F) Other tranaction costs | (G) Performance fees |
|---|---|---|---|
| -2.8% | -3.6% | -3.8% | -0.2% |

Total (check) -7.6%

Note – in this example, the ratios have been based on the opening NAV, and not the average NAV over the period

**InREV**

| (A) Fund Management Fees | (B) Fund Operating Expenses | (D) Property Expense Ratio | (F) Performance fees |
|---|---|---|---|
| -2.1% | -0.7% | -0.8%<br>-3.8% | -0.2% |

| (C) Total Expense Ratio ("TER") (A+B) | (E) Real Estate Expense Ratio ("REER") (C+D) | (F) Performance fees |
|---|---|---|
| -2.8% | -7.4% | -0.2% |

Total (check) -7.6%

**Annex 4**

Attribution of costs into proposed framework (GAV basis) together with the INREV approach

**Example PUT**
**Step 3 - Analysis of GAV total return and extraction of source numbers for REER**
**(as defined by AREF with InREV calculation comparative)**

| | Performance related values (absolute) | Performance related value per unit | Attribution of Total Return* | Performance attribution: Income less cost of gearing | Performance attribution: Expenditure | Performance attribution: Capital appreciation | Expense ratio source and disclosure values: Base fee | Transaction fee (Fund Manager) | Corporate costs | Corporate taxation | Valuation fees | Non-recoverable property costs | Transaction costs (3rd party) | Performance fees |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue Account** | | | | | | | | | | | | | | |
| Net rental income | 13,000,000 | 130,000 | 7.7% | 7.7% | | | | | | | | | | |
| Repairs and maintenance | (70,000) | (700) | 0.0% | | 0.0% | | | | | | | 0.0% | | |
| Empty rates and service charge shortfall | (255,000) | (2,550) | -0.2% | | -0.2% | | | | | | | -0.2% | | |
| Letting fees | (140,000) | (1,400) | -0.1% | | -0.1% | | | | | | | -0.1% | | |
| Other non-recoverable property expenditure | (300,000) | (3,000) | -0.2% | | -0.2% | | | | | | | -0.2% | | |
| Bank interest payable on "gearing" | (3,600,000) | (36,000) | -2.1% | -2.1% | | | | | | | | | | |
| Amortised debt set up costs | (100,000) | (1,000) | -0.1% | -0.1% | | | | | | | | | | |
| Fund Manager's base fee | (1,537,500) | (15,375) | -0.9% | | -0.9% | | -0.9% | | | | | | | |
| Fund Manager's performance fee | (200,000) | (2,000) | -0.1% | | -0.1% | | | | | | | | | -0.1% |
| Valuation fees | (100,000) | (1,000) | -0.1% | | -0.1% | | | | | | -0.1% | | | |
| Corporate costs | (400,000) | (4,000) | -0.2% | | -0.2% | | | | -0.2% | | | | | |
| Tax | (200,000) | (2,000) | -0.1% | | -0.1% | | | | | -0.1% | | | | |
| **Income return** | £6,097,500 | £60,975 | **3.6%** | | | | | | | | | | | |
| **Balance Sheet** | | | | | | | | | | | | | | |
| Direct property A (revaluation uplift being £106m - £100m) | 6,000,000 | 60,000 | 3.5% | | | 3.5% | | | | | | | | |
| Direct property B (revaluation uplift being £53m - £48m) | 5,000,000 | 50,000 | 3.0% | | | 3.0% | | | | | | | | |
| Direct property C (revaluation uplift being £46m - £4m - £39m) | 3,000,000 | 30,000 | 1.8% | | | 1.8% | | | | | | | | |
| Direct property B ("other" transaction fees being stamp duty/other legal £2m) | (2,000,000) | (20,000) | -1.2% | | -1.2% | | | | | | | | -1.2% | |
| Direct property B (transaction fees of £0.5m paid to Fund Manager) | (500,000) | (5,000) | -0.3% | | -0.3% | | | -0.3% | | | | | | |
| Direct property C ("other" transaction fees - stamp duty/other legal £1m and other £0.8m) | (1,800,000) | (18,000) | -1.1% | | -1.1% | | | | | | | | -1.1% | |
| Direct property C ("project" transaction fees paid to Fund Manager £0.1m) | (100,000) | (1,000) | -0.1% | | -0.1% | | | -0.1% | | | | | | |
| Spread on new units issued in period (£1,075,000 - £1,000,000 = £75,000 x 35 units = £2.625m) | 2,625,000 | 26,250 | 1.6% | | | 1.6% | | | | | | | | |
| **Capital return** | £12,225,000 | £122,250 | **7.2%** | | | | | | | | | | | |
| **Total return (and components thereof)** | | | **10.8%** | **5.5%** | **-4.5%** | **9.8%** | **-0.9%** | **-0.4%** | **-0.2%** | **-0.1%** | **-0.1%** | **-0.5%** | **-2.2%** | **-0.1%** |

Performance denominator (opening GAV per unit) £1,692,308

Note
- GAV is NAV plus debt.
- The above attribution is based on a "simple" total return calculation.
- In reality, quarterly returns would be calculated which would, when compounded, provide a rounding difference within the attribution analysis.

**AREF**

| (A) Fund Management Fees | (B) Fund Operating Expenses | (D) Property Expense Ratio | (F) Other tranaction costs | (G) Performance |
|---|---|---|---|---|
| -1.3% | -0.4% | -0.5% | -2.2% | -0.1% |

| (C) Total Expense Ratio ("TER") (A+B) | (E) Real Estate Expense Ratio ("REER") (C+D) | (F) Other tranaction costs | (G) Performance fees |
|---|---|---|---|
| -1.7% | -2.1% | -2.2% | -0.1% |

Total (check) **-4.5%**

**InREV**

| (A) Fund Management Fees | (B) Fund Operating Expenses | (D) Property Expense Ratio | (F) Performance fees |
|---|---|---|---|
| -1.3% | -0.4% | -0.5%<br>-2.2% | -0.1% |

| (C) Total Expense Ratio ("TER") (A+B) | (E) Real Estate Expense Ratio ("REER") (C+D) | (F) Performance fees |
|---|---|---|
| -1.7% | -4.4% | -0.1% |

Total (check) **-4.5%**