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Workshop:

Luxembourg's Role as a European Real Estate Investment Centre

Moderator: Keith Burman, Senior Vice President, Brown Brothers Harriman
Joëlle Hauser, Partner, Clifford Chance
Raymond Krawczykowski, Partner, Deloitte

Real Estate Investment Funds: Luxembourg, the European Centre

Moderator

*Keith Burman, Senior Vice President, Brown
Brothers Harriman, Luxembourg*



Panelists

*Joëlle Hauser, Partner, Clifford Chance,
Luxembourg*

*Raymond Krawczykowski, Deloitte,
Luxembourg*



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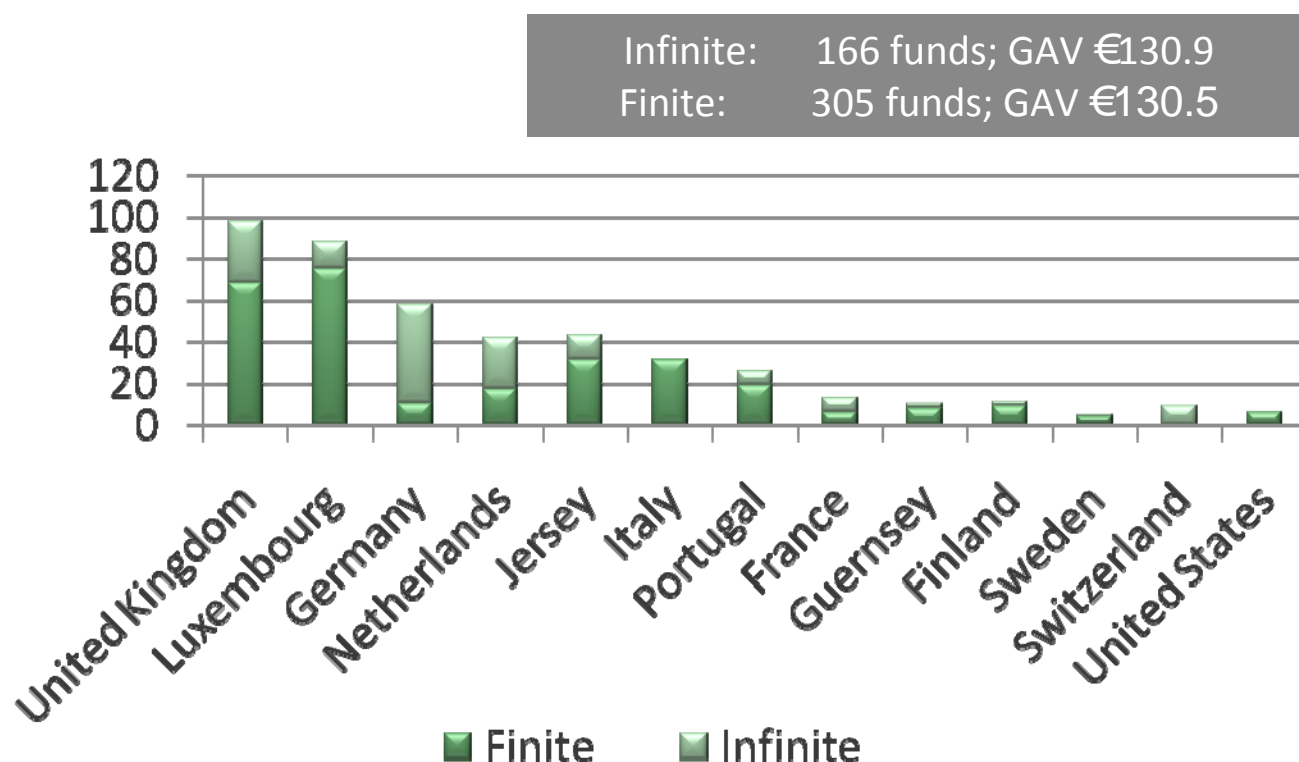
- Luxembourg – European Centre for International Real Estate Funds
- Luxembourg REIFs track record to date...
- Why has Luxembourg been successful for REIFs?
- How does Luxembourg fit with the AIFM Directive?



Luxembourg REIFs track record to date...



FINITE AND INFINITE FUNDS BY DOMICILE



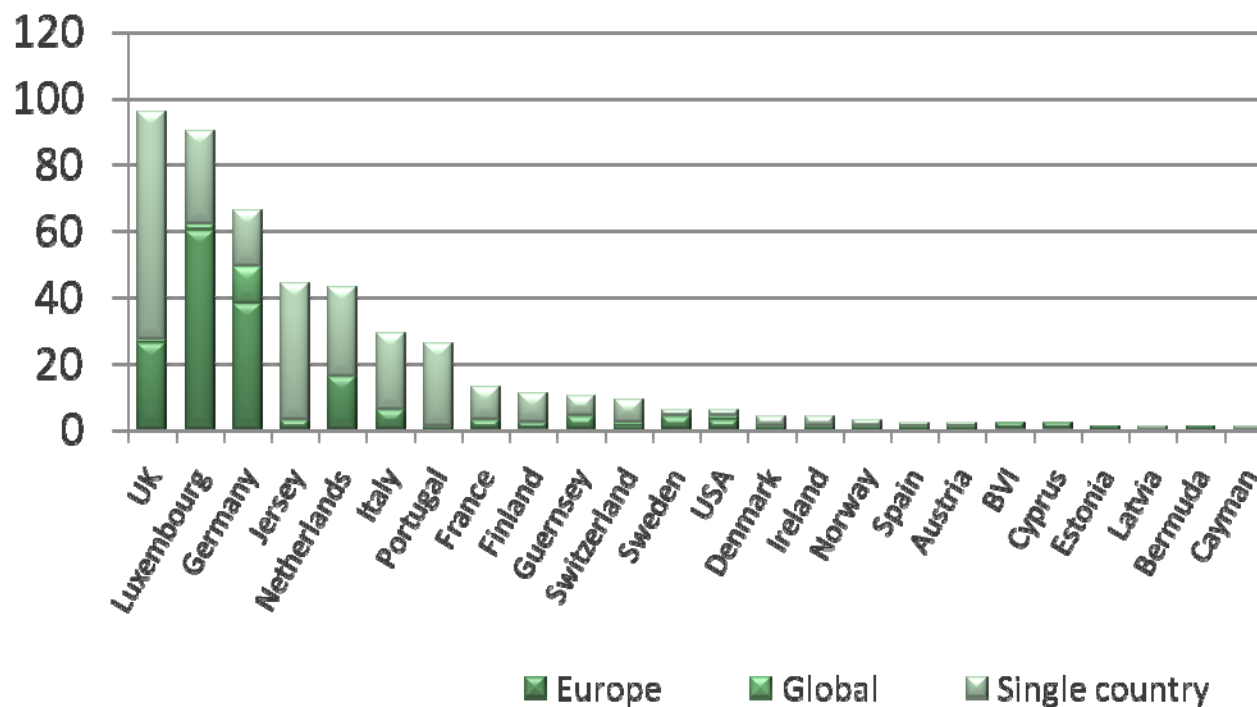
- Luxembourg is the second most frequent domicile in the INREV database
- Only 65 out of 156 regulated Lux REIFs currently included in INREV database
- 85% of Luxembourg REIFs are closed-ended, compared with 70% of UK REIFs and 17% of German REIFs

Source: INREV Database, April 2010

Luxembourg REIFs track record to date...

INREV

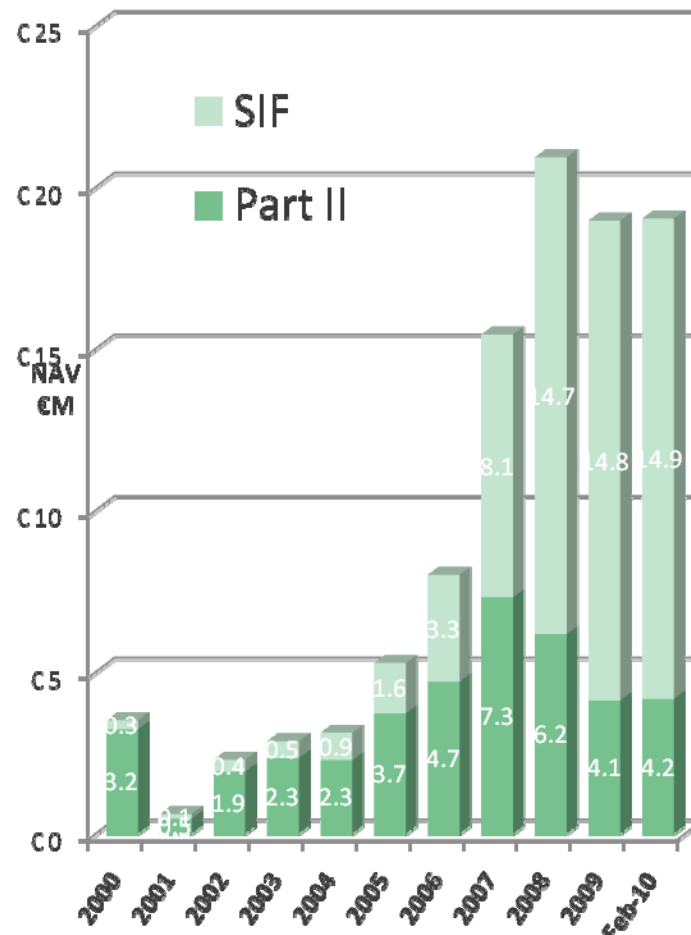
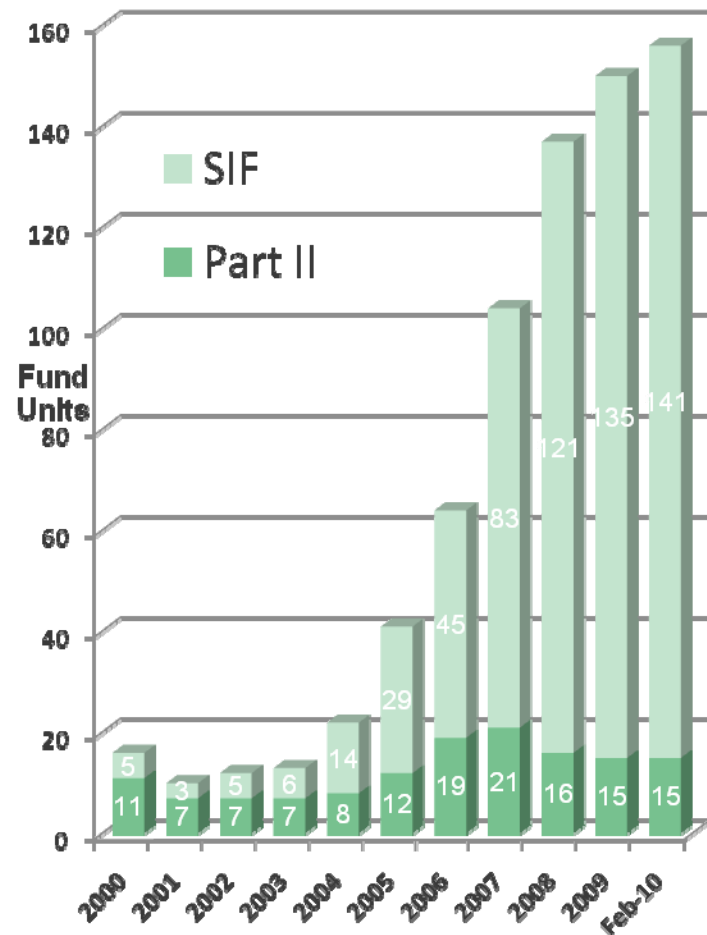
INVESTMENT COUNTRIES BY DOMICILE



- 72% of the REIFs in Luxembourg invest in more than one country, compared to 28% in the UK
- Luxembourg supports 33% of INREV's multi-country REIFs

Luxembourg REIFs track record to date...

REIF Fund Units and Net Assets

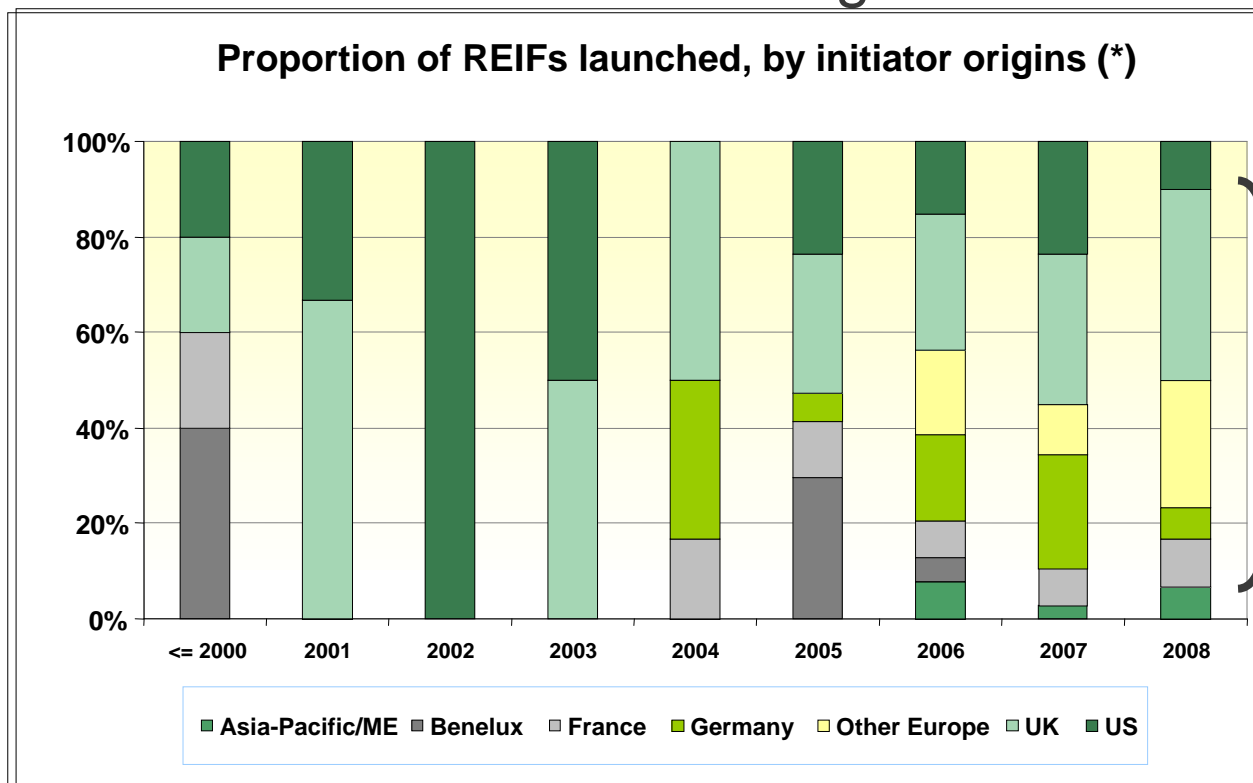


- Strong growth in 2007 and 2008
- 2009 shows a small increase in fund numbers, but a fall in Net Assets
- In the Part II funds, this is partly explained by fund term expiry and liquidation

Source: ALFI/CSSF

Luxembourg REIFs track record to date...

Initiator Origin – Direct REIFs



- UK Managers continued to be the most active
- Other Europe increased its proportion of new launches
- German & US initiators were less active

84% of new launches in 2008 were from European Initiators

Funds per Launch YEAR

Year	# Funds per Launch
<= 2000	5
2001	3
2002	3
2003	2
2004	6
2005	17
2006	39
2007	38
2008	30

Source: ALFI REIF Survey 2009



Luxembourg REIFs track record to date...

- Luxembourg – European Centre for International Real Estate Funds
- European centre for international/global players

- Aberdeen
- AMB Capital
- Aviva
- BlackRock
- BNP Paribas
- CBRE Investors
- Deutsche Bank
- Fidelity
- Franklin Templeton
- Heitman

- Henderson Global Investors
- Hines
- ING
- JPMorgan
- LaSalle
- Morgan Stanley
- Pramerica
- Prologis
- Tishman Speyer
- UBS



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- How does Luxembourg fit with the AIFM Directive?



Why has Luxembourg been successful for REIFs?

- **FLEXIBLE FUND STRUCTURING**
- Distribution Success
- Established & Stable Investment Centre
- Tax Neutral
- Industry Best Practices

INVESTOR/MANAGER LEVEL CONSIDERATIONS

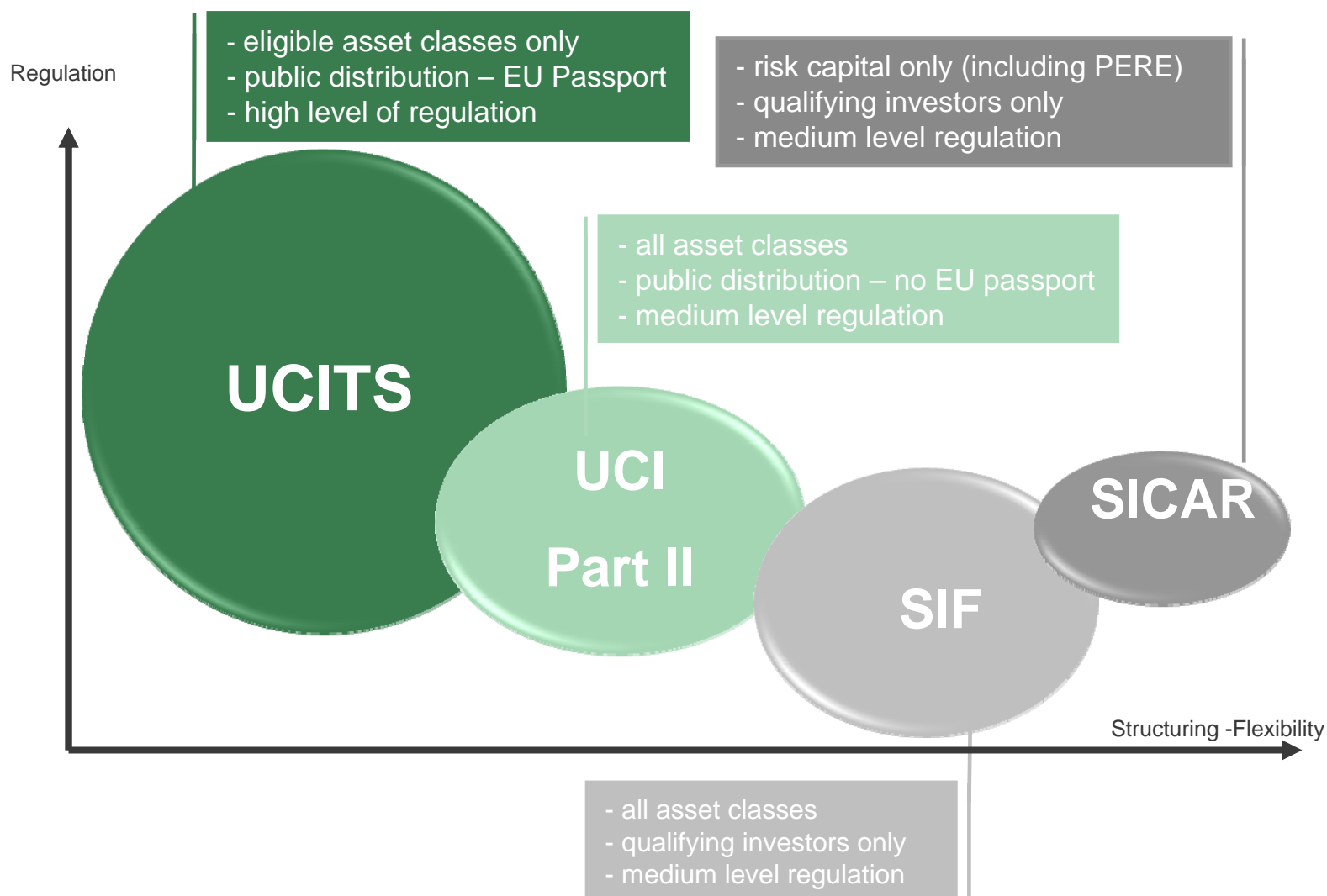


FUND LEVEL CONSIDERATIONS



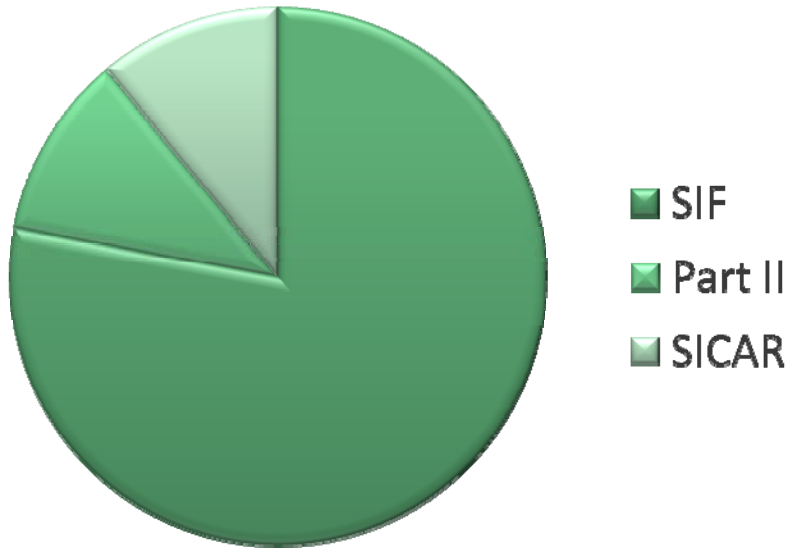
INVESTMENT LEVEL CONSIDERATIONS

Flexible Fund Structuring



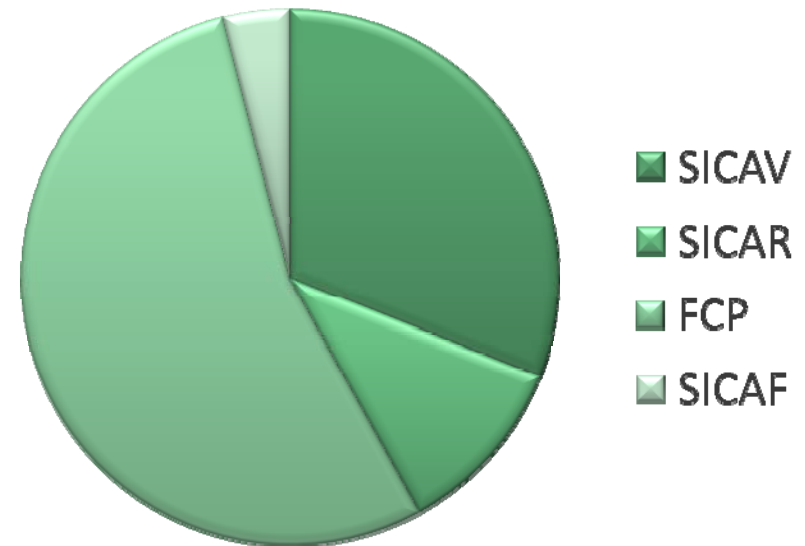
Regulatory and Legal Regime

Regulatory Regime



More than half of the funds use the FCP as the vehicle, usually in combination with the SIF regime

Legal Regime



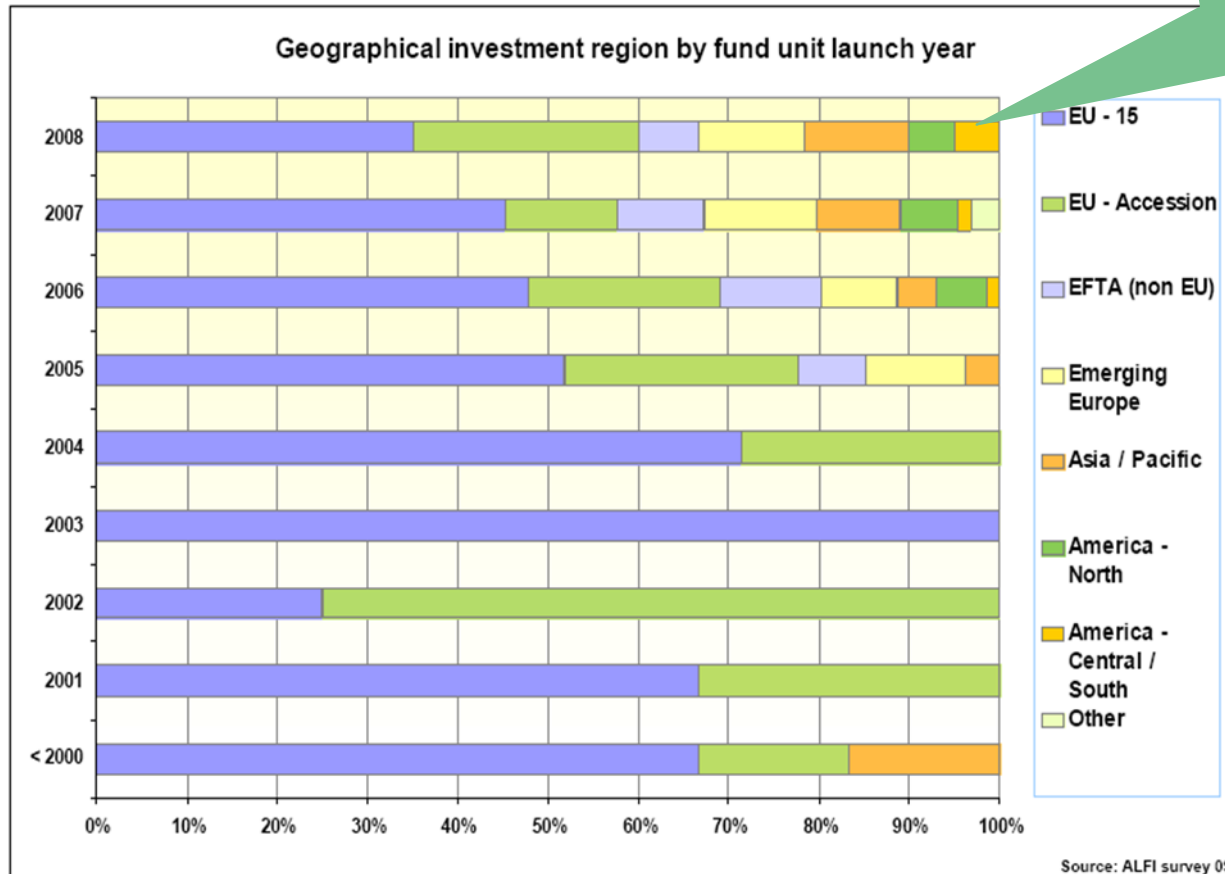
Flexible Fund Structuring



Geographical Investment Strategy Geographical Diversity Trend since 2006

Regions per
Launch YEAR

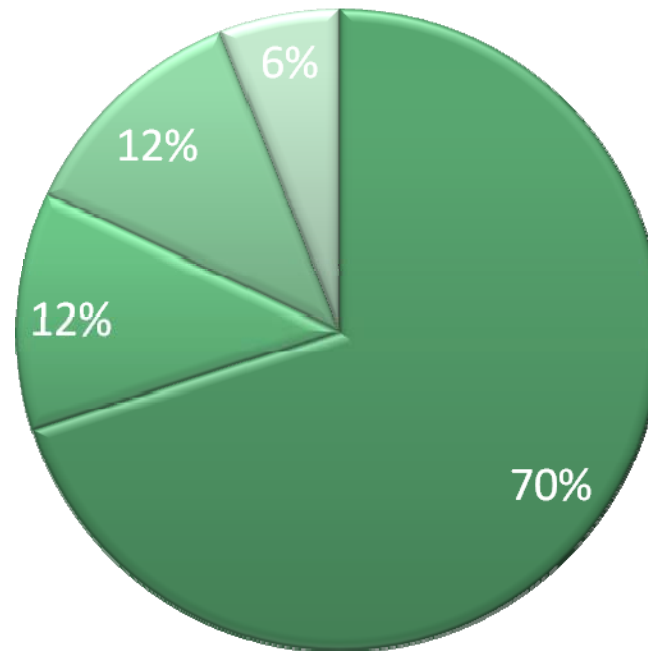
2008 60
2007 64
2006 71
2005 27
2004 7
2003 2
2002 4
2001 3
< 2000 6



7 regions cited in 2008 funds, compared with 3 regions prior to 2005

Investor Liquidity

- Only 6% of the Funds are fully Open
- 70% Closed-ended
- Luxembourg has seen limited outflows from REIFs as a result



- Closed
- Semi-Open (Not continuous)
- Open - Restrictions
- Open - No Restrictions



Real Estate Trends

- Thematic Funds
- “SRI” funds
 - Green/“sustainable” RE funds
 - Green infrastructure (wind, solar, water) funds
 - Sharia compliant PE/RE funds
 - Timber funds
- “Distressed (property) asset” funds
- Debt Funds



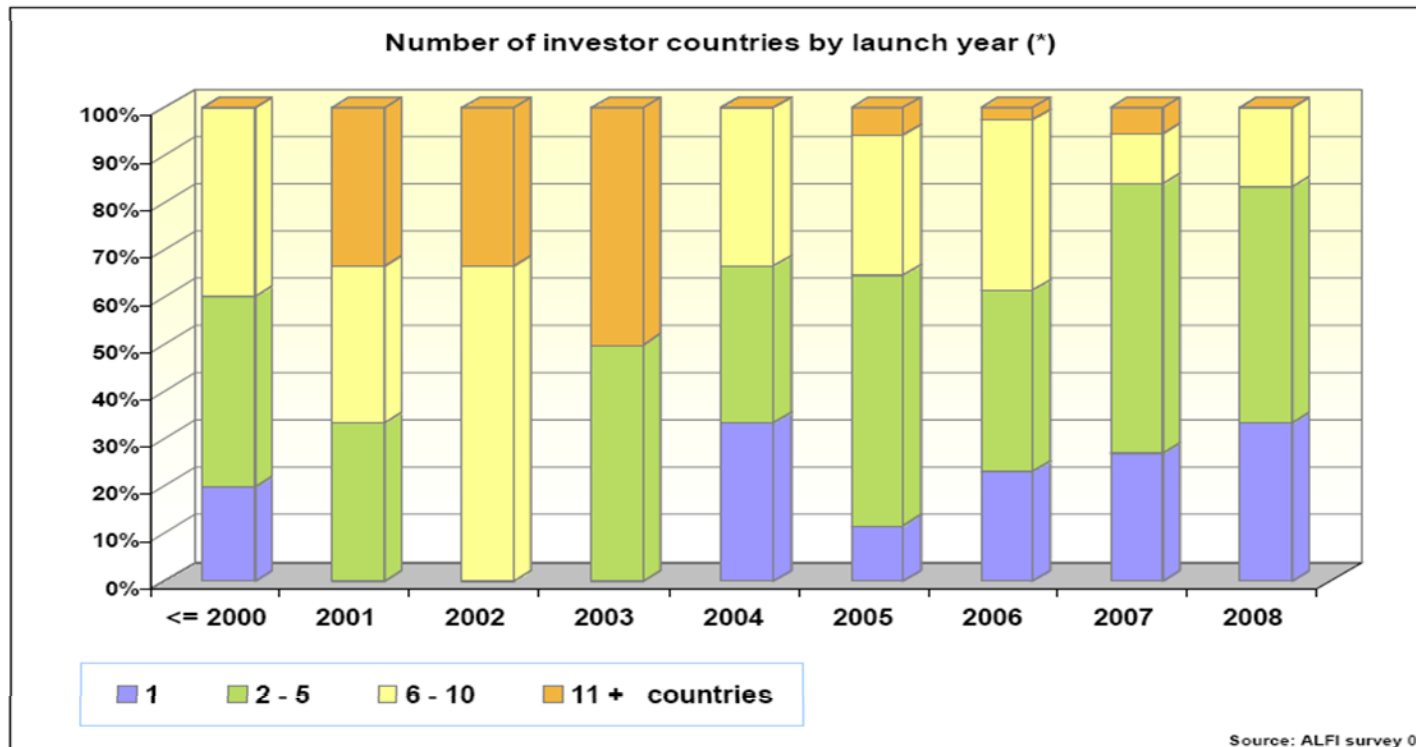
Why has Luxembourg been successful for REIFs?

- Flexible fund structuring
- **DISTRIBUTION SUCCESS**
- Established & Stable Investment Centre
- Tax Neutral
- Industry Best Practices

Distribution Success

...

Distribution – Direct REIFs



- Distribution remains limited
- 70% of funds are sold in less than 5 countries
- Funds for sale in a single country are a growing proportion

(*) This graph shows the launch year of fund units that are included in the REIF Survey 2008. It is NOT a cumulative sequence.

Funds per Launch YEAR

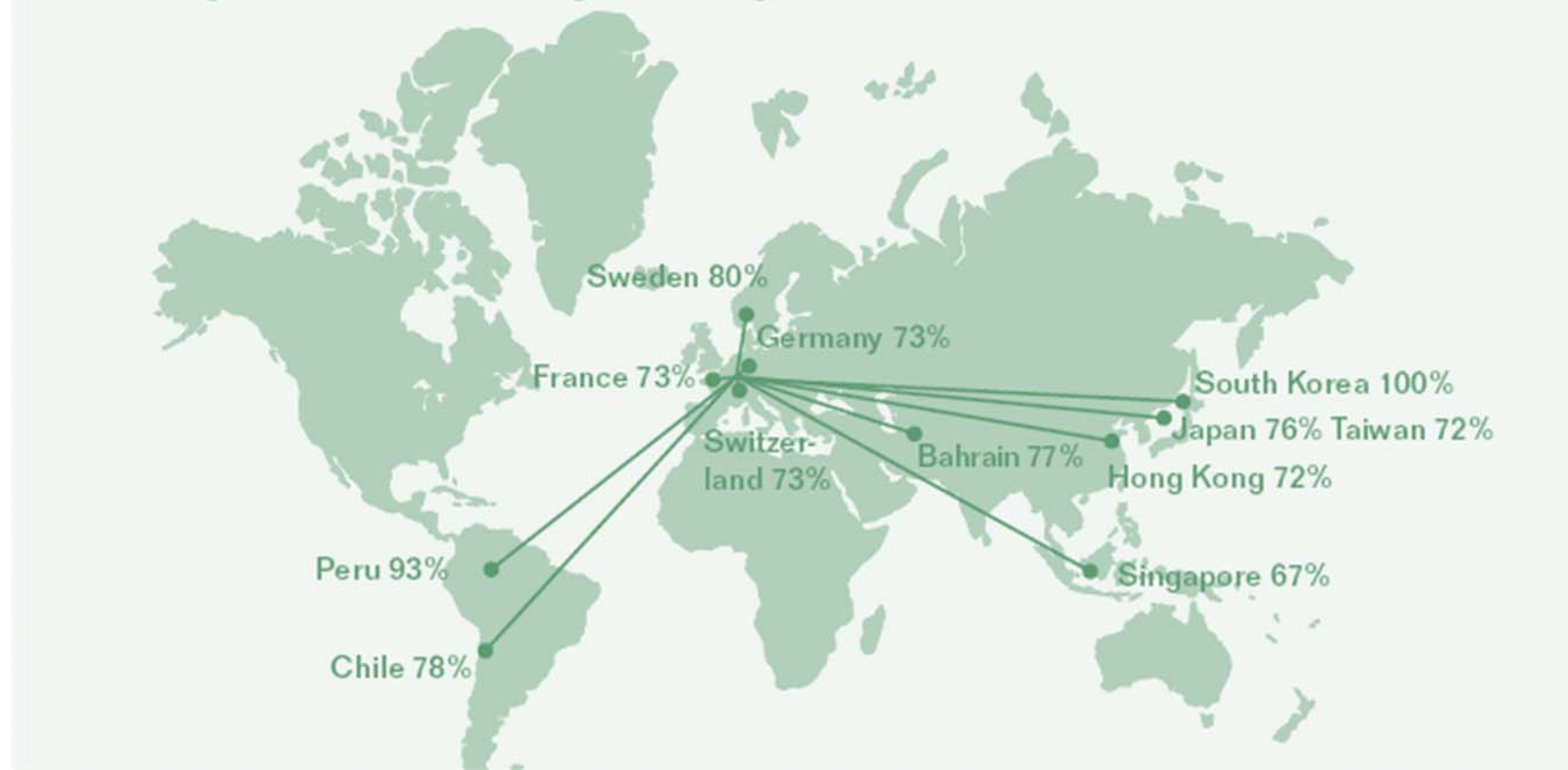
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Source: ALFI REIF Survey 2009

Distribution Success

UCITS Distribution: Luxembourg Market Share

Luxembourg market share of foreign funds registered for sale





Why has Luxembourg been successful for REIFs?

- Flexible fund structuring
- Distribution success
- **ESTABLISHED & STABLE INVESTMENT CENTRE**
- Tax Neutral
- Industry Best Practices

The right environment for RE: the Luxembourg DNA

Pro-Business Attitude of Authorities

- Quick and efficient approval/setup process
- Direct and personal contact with CSSF (regulator) and Tax Administration
- Binding verbal agreements with Tax Administration

Flexibility, Security and Predictability

- Laws and regulations provide maximum structuring flexibility
- Investor protection
- Stable political, economic and social environment

The right environment for RE: the Luxembourg DNA

Top Tier Financial Infrastructure

- Highly qualified and multi-lingual workforce
- Strong established reputation as a European on-shore financial centre
- Presence of global players

Pragmatic & Accessible Supervisor

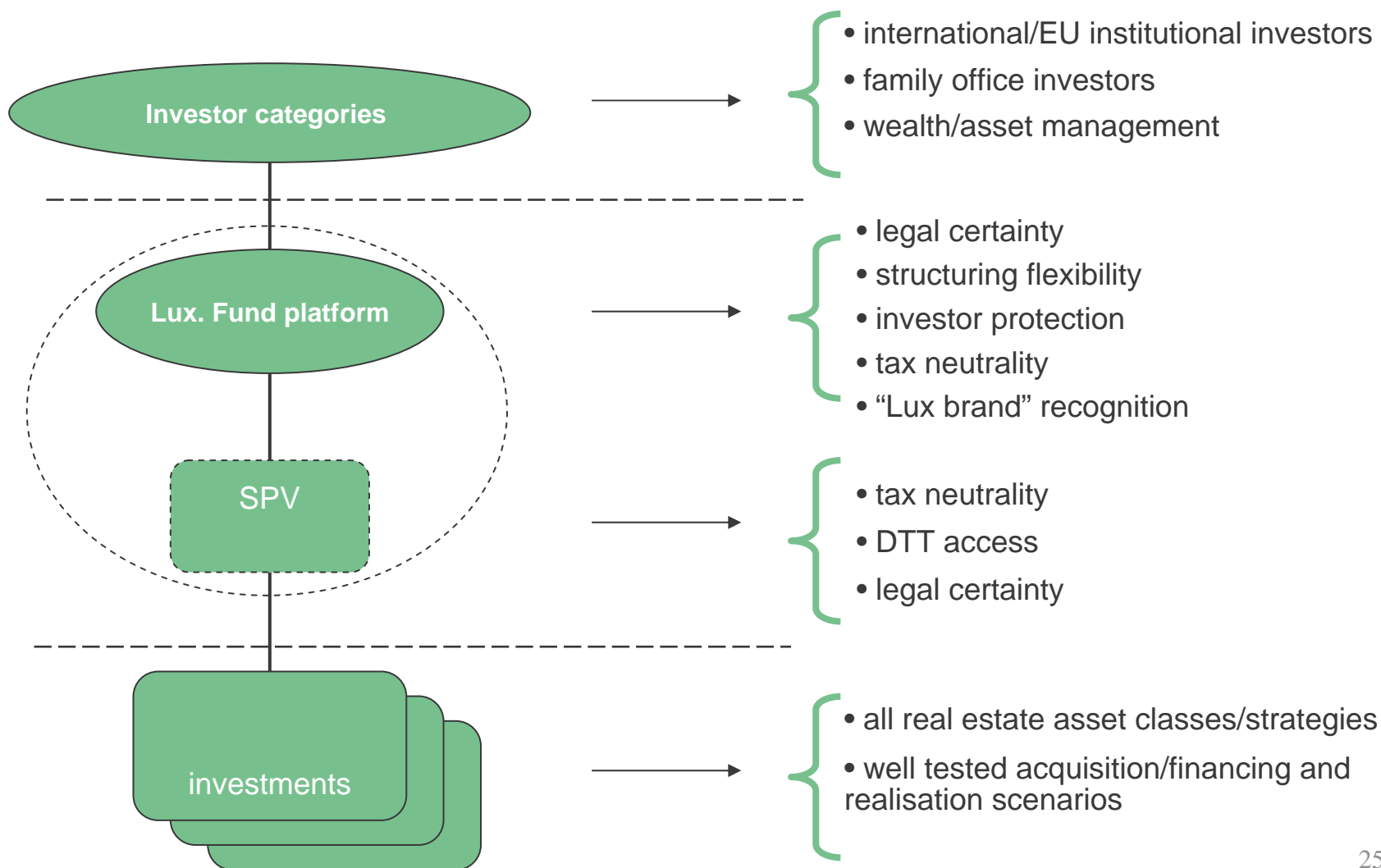
- Strong reputation of supervisor facilitates cross-border distribution
- Accessible: close relationship with market players
- Pragmatic interpretation of law and supervision



Why has Luxembourg been successful for REIFs?

- Flexible fund structuring
- Distribution success
- Established & Stable Investment Centre
- **TAX NEUTRAL**
- Industry Best Practices

Tax Neutral





Why has Luxembourg been successful for REIFs?

- Flexible fund structuring
- Distribution success
- Established & Stable Investment Centre
- Tax Neutral
- **INDUSTRY BEST PRACTICES**

IFRS

- 53 % of Real Estate funds prepare financial statements under IFRS (ALFI REIF Survey 2009)
- Alternately LuxGAAP can be used
- Service providers in Luxembourg are well-trained in producing both

RICS Valuation

- RICS is by most far the common standard used (64% ALFI REIF survey 2009)
- INREV best practices requirements in this area are entirely compatible with Luxembourg fund regulations

INREV

- INREV and LuxGAAP NAVs are compatible
- Many funds use IFRS for financial statements and adjust to an INREV based NAV
- There are many leading examples of the full application on INREV guidelines into Luxembourg fund structures enabled by the nature of Luxembourg regulatory requirements
- ALFI representatives are in close contact with INREV and much of the guidance and best practices recommended by ALFI is in line with INREV requirements

Formal Risk Management

- Luxembourg regulated structures require a degree of formal risk management, however this is generally proportional and pragmatic and in line with best practices

Corporate Governance

- INREV corporate principles are easy to embed into Luxembourg regulated funds
- Funds use a variety of structures to achieve this, UACs (Unitholders advisory committee), independent directors ,audit committees pricing and valuation committees etc. depending on the fund style



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How does Luxembourg fit with the AIFM Directive?

- Key Objectives
 - Systemic Risk
 - Transparency
 - Investor Protection and functioning of the financial markets
 - Single Market / Investor Access to competitive products

- Policy Considerations
 - Legislative process
 - Timeline
 - Level 2 measures



How does Luxembourg fit with the AIFM Directive?

- Key issues thus far
 - Scope
 - Valuation
 - Depository
 - Delegation
 - Third country issues

AIFM Directive – Potential Timeline...



2009	2010										2011	2012	2013	2014				
Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct		Q4	Q4					
EU Council of Ministers (Swedish Presidency)	Spain takes over Presidency					Belgium takes over Presidency												
	Spanish continue to seek consensus amongst Member States				Vote at EcoFin	Trilogues between EU Council, ECON and EU Commission												
European Parliament	ECON Committee submits amendments to Gauzes Report	Gauzes receives 2000 amendments; plans to issue combined proposal			Vote at ECON											Directive comes into force	Existing AIFM have 12 months to comply	Potential grandfathering period for existing funds
European Commission														European Commission holds Level 2 discussions with CESR & others				



How does Luxembourg fit with the AIFM Directive?

Business Impact:

- Overall consensus of the real estate industry
 - Intention to create a European-wide market for non-UCITS funds to invest and market their products in the entire EU is welcomed
 - Debate on the "one-size-fits-all approach" which ignores specific aspects that set real estate funds apart from other investment funds
- Increased levels of regulation, supervision and compliance
 - Managers may reconsider the competitiveness of the EU business environment
 - Risk of two-tier regulatory system
 - Between European and non-European AIFMs and AIFs
 - Between AIFs caught by the AIFM Directive and other investment vehicles which have been carved out, e.g. sovereign wealth funds, managed accounts, pension funds and insurance companies



How does Luxembourg fit with the AIFM Directive?

Business Impact:

- Protecting existing fund arrangements
 - What will be the cost of compliance?
 - EU managers need to get authorised to continue to manage or market their funds
 - Funds may need to be restructured to ensure compliance with the AIFM Directive, e.g. new capital requirements, removing multi-manager structures

- Future fund arrangements
 - Opportunities for non-EU AIFMs/AIFs in the EU market may be severely limited
 - Increased consolidation of real estate funds in the European market
 - costs/benefits of managing smaller funds increasingly uneconomical?



How does Luxembourg fit with the AIFM Directive?

Luxembourg today for Real Estate Investment Funds:

- Third Countries
- Fund of Funds
- Real Estate Custody
- Real Estate Valuation/NAV
- Formal Risk Management
- Formal Delegation



■ Why will Luxembourg be a good fit under the AIFM Directive?

- Luxembourg is currently **THE** domicile of choice for UCITS and will become a major partner for Non-UCITS
- AIFM Directive will provide a European passport for management and AIF distribution. Luxembourg is the cross-border distribution domicile of choice
- Existing SIF framework is already largely compliant with many of the future AIFM Directive requirements
- Luxembourg is likely to be one of the first Member States to implement into National legislation

Q & A



AIFM Directive – The legislative process so far...

- First draft of the European Commission published April 2009

- Council of the European Union
 - 3 further drafts produced by the Swedish presidency (the last dated December 2009)
 - Report of Jean-Paul Gauzès, French MEP, in November 2009 – over 1,600 amendments be MEPs tabled to this Report
 - Spanish Presidency published the last draft in March 2010
 - Could we see the AIFM Directive roll into the Belgium presidency?

- Proposed deadlines – likely to slip?
 - Still some major sticking points – AIFM Directive taken off the ECOFIN agenda in March 2010
 - Only minority of MS oppose the AIFM Directive – BUT enough votes to prevent a qualified majority approval in the European Parliament. Political horse-trading likely...
 - Public consultation now over – AIFM Directive Council Working Group aiming for an agreed form text by end of July 2010 (plenary vote in the EP scheduled)
 - ECON vote in May 2010 – back on the agenda for next ECOFIN meeting on 18 May 2010
 - Implementation into national law in 2012
 - Various transitional provisions apply

How does Luxembourg fit with the AIFM Directive?



Issue	Commission proposal	What's changed?	Problems?
Definition of AIF	Very broad. Captures closed-ended, open-ended and listed funds and other vehicles, and possibly LPs. Ordinary property investment and trading companies and REITS could also be caught.	No significant change.	Criticism of a "one size fits all approach". Real estate funds do not pose systematic risk to financial system.
Investors	Directive covers investments made by professional investors.	Later drafts have recognised that some categories of AIF, e.g. open-ended real estate funds, are accessible to retail investors and that MS may (i) allow for marketing to retail investors within their territory; and (ii) apply additional regulatory controls for this purpose.	Difficult to achieve full harmonisation if national requirements and practices are taken into account and MS may impose stricter requirements.
Capital requirements	AIFM must hold and retain minimum capital of EUR 125,000. Where aggregate value of fund's assets exceeds EUR 250 million, AIFM must hold additional capital equal to 0.02% of the amount by which the aggregate value exceeds EUR 250 million – capped at EUR 10 million.	No change.	Problematic for real estate funds that are not part of larger investment management organisations.
Delegation	Single authorised AIFM for each AIF, with responsibility for all of the AIF's investment and risk management functions – delegation only to another AIFM authorised under the Directive. Marketing, administrative and property management functions may be delegated to non-authorised persons. Delegation to be authorised by regulatory authorities in advance. AIFM remains strictly liable.	Delegation now only subject to prior notification of the regulatory authorities.	Local expertise not utilised. Delegation is extensive in real estate fund structures – new measures likely to increase costs and delays.



How does Luxembourg fit with the AIFM Directive?

Issue	Commision proposal	What's changed?	Problems?
Valuation	Independent (legally or functionally) valuer must be appointed – if not based in EU, valuer must be subject to equivalent valuation standards and rules. Fund assets must be valued at least once a year and each time shares or units are issued or redeemed.	No change.	Significant additional operation and management costs – illiquid nature of underlying assets. No distinction between valuation of financial instruments/shares and real property.
Depositaries	Independent depositary to be appointed – can only be an EU credit institution established in the home MS of the EU AIF. Depositary can only delegate to other EU credit institutions.	Gauzès draft permits the depositary of an EU AIF which holds financial instruments to delegate its functions to non-EU entities.	One of the remaining open issues under the AIFM Directive.
Leverage	Limits imposed on high levels of leverage – check by fund managers to be made every quarter. Effect = disclosures to be made to investors and competent authorities. Possibly a need to aggregate information at European level (ESMA)	Latest drafts extends obligations to non-EU AIFMs managing non-EU AIFs.	Further limits are expected to be introduced depending on the nature of the underlying fund – area for real estate fund managers to watch.



How does Luxembourg fit with the AIFM Directive?

Issue	Commission proposal	What's changed?	Problems?
<p>Marketing rules</p> <p>This is potentially the biggest issue and is likely to be subject to much change.</p>	<p>Passport to market EU AIFs throughout the EU to professional investors.</p> <p>EU AIFM may only market a non-EU AIF in the EU if the fund's home State has signed an agreement with the relevant MS, agreeing to tax co-operation and information exchange requirements. Stringent authorisation process for non-EU AIFM to market any AIF in the EU – regime of equivalence applied to domicile of non-EU AIFM and comparable access to its market for EU operators.</p> <p>Non-EU AIFs must be marketed under existing private placement laws in force in the relevant EU MS for 3 years – passport to become available in 2014.</p>	<p>Gauzès draft suggests that:</p> <ul style="list-style-type: none"> •Non-EU AIFMs would be able to apply for a European passport subject to voluntary adherence with the Directive's requirements, registration with the European Securities and Markets Association ("ESMA") and the existence of an agreement between ESMA and the supervisory authority of the AIFM's home State. •The non-EU AIF would need to prove the existence in its home State of: (i) an information exchange agreement between its supervisory authority and the target EU State; (ii) an effective anti-money laundering and terrorism financing system; (iii) an OCDE-type tax agreement; and (iv) reciprocity for European products. 	<p>Protectionist measures make it difficult for :</p> <ul style="list-style-type: none"> •EU AIFM to market non-EU AIF in the EU. •Non-EU AIFM to continue business in the EU. <p>Until 2014, non-EU AIFs can only be marketed in the EU where this is currently allowed under the domestic law of the relevant MS.</p> <p>Can AIFs rely on the marketing passport under the Prospectus Directive, or is compliance with the AIFM Directive also required?</p> <p>Real estate funds are prime example of an investment fund which operates in a global market – new regime is extremely restrictive and inappropriate for continued growth in emerging markets.</p>

Comparison of Real Estate Fund Structures: Germany, the UK and Luxembourg



Characteristic of structure	Germany: Spezial-Sondervermögen	UK: Limited Partnership	Luxembourg: Specialised Investment Fund
Legal form	Co-ownership of assets	Limited Partnership	SICAV, SICAF, FCP, SCA, SARL
Duration	Usually 8 years	Usually 7-10 years (can be unlimited)	Limited or unlimited
Supervisory authority	BaFin (without prior approval)	None	CSSF
Launch	Possible without prior approval by private placement No listing – no free transfer	Private placement Listing is difficult	Possible without prior approval by private placement Listing possible Can be converted into Part II UCITS
Management	German management company (Master KAG) Master KAG can be replaced – but transfer tax	Managing GP – flexible governance structure	Management company if FCP
Service providers	Custodian has large powers	Flexible choice of service providers – custodian not required (if used, no location requirements)	Custodian must be based in Luxembourg Large number and broad expertise of service providers
Minimum commitment	EUR 10 million	EUR 10 million	EUR 10 million
Financing	Internal loan restrictions Max. 50% of the market value of the properties may be charged Qualifies for real estate quota	No statutory rules on capital (other than maintenance of a nominal amount) No internal loan restrictions Does not qualify for real estate quota	Capital may be fixed/variable, partly or fully paid-up, with or without commitments No limits on internal loans Can qualify for real estate quota

Comparison of Real Estate Fund Structures: Germany, the UK and Luxembourg



Characteristic of structure	Germany: Spezial-Sondervermögen	UK: Limited Partnership	Luxembourg: Specialised Investment Fund
Distributions>Returns	Limitations on distribution of dividends	Preferred return 8% p.a. Carried interest of 20%	Flexible distribution policy Performance fees
Leverage	Max. 50% of the market value of the properties Max. 30% short-term leverage for liquidity purposes	Max. 75% of the fair value of investment	Leverage limits
Risk diversification	More than 3 assets	No legal restrictions	30% issuer limit – exceptions during first 4 years
Open-ended/closed-ended fund	Open-ended Mandatory redemption right every 2 years	Closed-ended	Open-ended or closed-ended
Tax	Tax transparent	Tax transparent	Substance in Luxembourg required to benefit from efficient tax regime 0.01% subscription tax DTT in certain cases Tax transparent if FCP
Valuation	Fair value Special rules for specific assets	No legal restrictions	Fair value Special rules for specific assets
Issue price	NAV or fixed price for initial issuance of shares	No legal restrictions	NAV or fixed price
Investors	Natural persons excluded Investment Advisory Committee	In practice – open to sophisticated institutional investors (e.g. insurance companies)	Well-informed investors Minimum investment of EUR 125,000

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