Surveying IFRS for real estate
Current issues and financial statements survey 2010/2011
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1. Executive summary and key findings
Welcome to our latest survey of financial statements – and an analysis of some of the key financial reporting issues – of real estate investors reporting under IFRS. The 2010/2011 financial statements survey is the fifth consecutive real estate survey published by Ernst & Young. Over the last five years, the number of companies in our survey has increased from 25 in the first survey to 38 companies in the latest survey. The economic environment has changed significantly over this period and there has been much discussion about the valuation of and reporting on investment properties. Also, the real estate sector has come under increasing scrutiny from regulators. In our previous surveys, we analysed whether the changing environment also impacted the level of disclosures in the financial reporting of the real estate investment entities. In this year’s survey, we continue to focus on the issues likely to be significant in an ongoing challenging real estate market. We extended our survey beyond financial reporting into the area of sustainability reporting.

The following highlights emerged from our survey:

- As in prior years, more than 90% of the surveyed companies have adopted the fair value option available in IAS 40 for the measurement of their investment properties. No changes were reported in this respect.
- Consistent with previous years, most companies have had their portfolio valued by external valuers. Only 8% solely rely on internal valuations.
- The discounted cash flow (DCF) method continues to gain in popularity. Almost 50% rely exclusively on this method and another 30% apply it in the mix of valuation methods adopted.
- The number of companies that disclosed the assumptions applied in the valuation of investment properties has only marginally increased from 54% to 57% compared with last year.
- Also, the number of companies that reported valuation sensitivity analyses increased slightly compared with last year (from 45% to 49% of the surveyed companies).
- Despite a lack of detailed guidance on reliable measurement of fair values of Investment properties under construction (IPUC), very few companies indicate when IPUC can be reliably fair valued; yet the vast majority of the companies fair value all their IPUC, suggesting that reliability is less of an issue.
- 76% of the companies in our survey acquired real estate, but only 13% (five companies) report one or more business combinations. This would indicate that many companies in our survey were of the opinion that their acquisitions of real estate took the form of the purchase of an individual asset or a “single-asset entity” that does not constitute a business.
58% of the companies in our survey (2009: 40%) recognise goodwill on the balance sheet. As discussed above, only five companies entered into one or more business combinations in 2010. Three of the five companies noted that goodwill was mainly recognised due to recognising deferred tax liabilities at nominal value and not at fair value.

60% of respondents disclosed that they applied the value in use (VIU) method to test goodwill for impairment, but almost 40% do not disclose information on impairment testing.

Almost all of the companies (95%; 2009: 92%) have included information in the financial statements regarding compliance with debt covenants; most companies included actual covenants applicable and whether they comply with the covenants as of their balance sheet dates. However, only one entity provided a sensitivity analysis for one of its key covenants.

All but two entities in the survey presented an interest rate sensitivity analysis. Most entities disclosed the impact of either a 50 or 100 basis point change in interest rate.

In view of financing markets continuing to tighten and the real estate refinancing challenges, it may come as a surprise that we have identified only ten entities (26%) that more specifically addressed the going concern assumptions in this respect.

The majority of the companies mention that deferred tax is provided for using the liability method for all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts. The ongoing discussions on the measurement of deferred tax liabilities does not seem to have impacted the manner in which an entity expects to recover or settle the carrying amount of its assets and liabilities.

Of those companies that have joint ventures (82%), 42% apply the equity method and 58% apply the proportionate consolidation method. This suggests that, with the forthcoming changes under the new standard Joint Arrangements (IFRS 11), we may expect some changes in accounting, e.g., changes from proportionate consolidation to equity accounting.

Although we would expect the current economic circumstances to result in more frequent changes of classification of properties – in particular, from inventories or “held for sale”. We noted that very few transfers actually occurred.

Almost 80% of the surveyed companies cover sustainability in their annual reports, but there is a very wide variation in information provided. The vast majority does not yet report sustainability performance by means of key performance indicators (KPIs).
2. The survey
The Ernst & Young IFRS Real Estate survey provides a comparative analysis of selected accounting policies and disclosures in the financial statements and annual reports of 37 property companies from Europe, Australia, Asia and the Middle East. This year, we have also included an early adopter in Canada for a total of 38 companies. Our analysis is based on reading excerpts from the financial statements and annual reports of these companies. Our comments on the accounting policies and disclosures of a company are not meant to be read as a statement of compliance with IFRS.

In our previous surveys, we analysed the accounting policies and disclosures for the measurement of investment and development properties, debt covenants compliance, goodwill, deferred taxes, joint venture accounting and segment reporting. In this survey, we included acquisitions under the revised IFRS 3 Business Combinations and sustainability reporting. We also look ahead to the upcoming changes to IFRS.
The companies included in our survey are listed below:

<table>
<thead>
<tr>
<th>Company</th>
<th>Location</th>
<th>Financial year-end</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Property Trust ('GPT')</td>
<td>Australia</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Goodman International Limited ('Goodman Group')</td>
<td>Australia</td>
<td>30 June 2011</td>
</tr>
<tr>
<td>Stockland Trust ('Stockland')</td>
<td>Australia</td>
<td>30 June 2011</td>
</tr>
<tr>
<td>Westfield Group (Westfield Holdings Ltd &amp; controlled entities) ('Westfield')</td>
<td>Australia</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Immofinanz AG ('Immofinanz')</td>
<td>Austria</td>
<td>30 April 2011</td>
</tr>
<tr>
<td>Confinimmo SA ('Confinimmo')</td>
<td>Belgium</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Beffimmo SCA ('Beffimmo')</td>
<td>Belgium</td>
<td>30 September 2010</td>
</tr>
<tr>
<td>Brookfield Office Properties ('Brookfield')</td>
<td>Canada</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Sponda PLC ('Sponda')</td>
<td>Finland</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Foncière des Régions SA ('Foncière')</td>
<td>France</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>GECINA ('Gecina')</td>
<td>France</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Klépierre SA ('Klepiere')</td>
<td>France</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Icade S.A. ('Icade')</td>
<td>France</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Unibail – Rodamco SA ('Unibail-Rodamco)</td>
<td>France/Netherlands</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Deutsche Annington Immobilien GmbH ('Deutsche Annington')</td>
<td>Germany</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Deutsche Wohnen AG ('Deutsche Wohnen')</td>
<td>Germany</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>IVG Immobilien AG ('IVG')</td>
<td>Germany</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>GAGFAH SA ('GAGFAH')</td>
<td>Germany</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Hong Kong Land Limited ('Hong Kong Land')</td>
<td>Hong Kong</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Gazit-Globe Limited ('Gazit-Globe')</td>
<td>Israel</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Beni Stabili S.p.A ('Beni Stabili')</td>
<td>Italy</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Corio NV ('Corio')</td>
<td>Netherlands</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Wereldhave NV ('Wereldhave')</td>
<td>Netherlands</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Goodman Industrial Trust ('Goodman')</td>
<td>New Zealand</td>
<td>30 June 2011</td>
</tr>
<tr>
<td>Globe Trade Center S.A ('GTC')</td>
<td>Poland</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Inmobiliaria Colonial, S.A ('Inmobiliaria')</td>
<td>Spain</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Castellum AB ('Castellum')</td>
<td>Sweden</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Fabege AG ('Fabege')</td>
<td>Sweden</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Kungsleden AB ('Kungsleden')</td>
<td>Sweden</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>PSP Swiss Property Group Ltd ('Swiss Property')</td>
<td>Switzerland</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Zublin Immonilen</td>
<td>Switzerland</td>
<td>31 March 2011</td>
</tr>
<tr>
<td>ALDAR Properties PJSC ('Aldar')</td>
<td>UAE</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>EMAAR Properties PJSC ('Emaar')</td>
<td>UAE</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>The British Land Company PLC ('British Land')</td>
<td>UK</td>
<td>31 March 2011</td>
</tr>
<tr>
<td>Hammerson PLC ('Hammerson')</td>
<td>UK</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Land Securities Group PLC ('Land Securities')</td>
<td>UK</td>
<td>31 March 2011</td>
</tr>
<tr>
<td>Derwent London PLC ('Derwent')</td>
<td>UK</td>
<td>31 December 2010</td>
</tr>
<tr>
<td>Segro PLC ('Segro')</td>
<td>UK</td>
<td>31 December 2010</td>
</tr>
</tbody>
</table>
3. Measurement of investment and development property and related disclosures
3.1 Introduction

2010 and 2011 were challenging periods for the real estate sector. 2011 was particularly challenging, as ongoing economic uncertainty further weakened commercial real estate markets around the world.

Against a backdrop of continuing financial insecurity, Europe’s leading property valuation professionals have come together to support the regional launch of the RICS Valuer Registration Scheme. This scheme sets out an approach to raise confidence in the delivery of valuation advice and reinforce the highest professional standards in property valuation – a key component underpinning most economic activity.

Nevertheless, there is an ongoing demand for higher quality valuations and increased transparency, particularly, in view of the sometimes significant differences between sales prices and property valuations and valuation differences between valuers. Uncertainty is a feature of investments in real estate regardless of geography, but it may be higher in inactive markets. Although investment activity increased somehow, investors are still predominantly looking for prime assets, leading to ongoing valuation uncertainty for secondary assets and less favoured investment countries. Investor sentiment towards secondary properties remains increasingly negative.

The application of both International Valuation Standards and IFRS requires appropriate disclosure of valuation assumptions and valuation uncertainty. This is also increasingly on the agenda of regulators across Europe.

In view of the above, it is interesting to see how well the property sector has responded to this transparency challenge. Has the quality of disclosures improved?

3.2 Fair value versus cost

Almost all companies (92%) in our survey have adopted the fair value option available in IAS 40 for the measurement of their investment properties. None of the companies has changed its accounting policy from cost option to fair value or vice versa. Three companies — Klepierre, Icade and Emaar — measure their investment properties at cost. Klepierre provided additional pro forma financial information that presents its investment properties on a fair value basis. Emaar and Icade disclosed the fair values of their investment properties.
3.3 External or internal valuations

The companies’ year-end valuations are mainly performed by external valuers (22 companies). Three companies valued their portfolio internally (8%) and ten companies (29%) valued their portfolio partly internally and partly externally. In most cases where internal valuations were used at year-end, external valuations were performed during the year on a part of the portfolio or external valuations were used to confirm the internal valuations. In addition, where part of the portfolio was valued internally at year-end, most companies have a policy that each property is valued externally at least once a year.

Compared to previous years, GAGFAH changed its valuation policy in 2010. In 2009, all investment properties were valued internally by GAGFAH at the end of each financial year and the value of each investment property was verified by an independent third-party appraiser on a rolling basis over a period of four years. In 2010, the full portfolio was valued externally. None of the other companies changed its valuation policy in 2010.

3.4 Valuation methodology

IAS 40 Investment Property defines fair value as “the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction”. Paragraphs 38 to 52 of IAS 40 provide substantial guidance on the methodology for valuing investment property. Fair value reflects market conditions as at the balance sheet date and a valuation at a specific moment in time. It assumes simultaneous exchange and completion, to avoid the variations in price that might otherwise take place. The fair value of the property is driven, at least in part, by the rental income from tenants and, if appropriate, outflows such as rental payments. In addition, the valuation is based on assumptions that would be considered to be reasonable and supportable by willing and knowledgeable parties.

The standard states that the best evidence of fair value will be given by comparable transactions of similar properties in a similar location and condition. However, with the low transaction volume in the market, it might be difficult to find comparable transactions. Nevertheless, the standard allows the fair value to be estimated by using other information when market values are not available. The other information that an entity may draw on includes:

- Transactions in an active market for dissimilar property (e.g., property of a different nature, condition or location, or subject to a different type of lease), as adjusted to reflect the differences
- Transactions in less active markets if they have been adjusted to take account of subsequent changes in economic conditions

Or

- Discounted cash flow projections based on estimated future cash flows (as long as these are reliable). These should be supported by existing leases and current market rents for similar properties in the same location and condition. The discount rate should reflect current market assessments of the uncertainty and timing of the cash flows.

In addition, paragraph 75(d) of IAS 40 requires disclosure of the methods used to determine the fair values of investment properties.
The mix of valuation methods applied is more or less consistent with the results of our prior year’s survey (2010), although the number of companies that applied a mix of valuation methods has increased (2009: 7; 2010: 11). The DCF method is applied by most of the companies (17), followed by a mix of valuation methods (11 companies), the mix mostly being DCF and the yield capitalisation method. Only a few companies indicate that they only use the yield capitalisation method. The comparable transactions method is mainly applied by some of the UK investment funds.

The valuation policy of Wereldhave clearly explains that any valuation is an estimate:

“The market value of these assets cannot be assessed using official quotations or listings. A valuation based on fair value is a time and place-based estimate. The estimate is based on a price level on which two well informed parties under normal market conditions would make a transaction for that specific property on the date of valuation. The fair value of a property in the market can only be determined with assurance at the moment of the actual sale of the property.”

Wereldhave discloses that it is responsible for the valuations, although the investment property portfolio is valued externally. It also explains how valuations are derived and which aspects of the investments have been taken into account:

“An external appraiser bases his fair value valuation on his own market knowledge and information. The valuation made by the appraiser is verified and approved by Wereldhave. The fair value is based on a net yield calculation, where market rents are capitalised and normative property expenses (such as the costs of maintenance, insurance and expenses) are deducted. The yields used are specific for the country, the location, the type of property, the level of maintenance and the general lettablity of every single property. The determination of applicable yields is based upon comparable transactions, added to market and building specific knowledge and remaining other assumptions.

Apart from assumptions with regard to yields, costs for future maintenance investments are also taken into account in the valuation. Furthermore, explicit assumptions are made per lettable location and per tenant with regard to the possibility of (re)letting, the start date of such (re)letting and the costs related hereto. Finally, adjustments are made for expected costs of vacancy (present and future) and for differences between the market rent and contractual rent. Sales costs at the expense of the buyer, including transfer tax, are deducted from the market value.”
Goodman applied a mix of valuation methods; the method depends on whether the market is active or inactive. Properties in an active market are valued externally based on comparable transactions. Properties in an inactive market are valued internally based on the DCF method.

**“Approach to determination of fair value”**

Valuations are determined based on assessments and estimates of uncertain future events, including upturns and downturns in property markets and availability of similar properties, vacancy rates, market rents and capitalisation and discount rates. Recent and relevant sales evidence and other market data are taken into account. Valuations are either based on an external, independent valuation or on an internal valuation. External valuations are undertaken only where market segments were observed to be active. This determination is made based on the criteria set out below:

- Function of the asset (distribution/warehouse or suburban office)
- Location of asset (city, suburb or regional area)
- Carrying value of asset (categorised by likely appeal to private investors (including syndicates), national and institutional Investors)

And

- Categorisation as primary or secondary based on a combination of location, weighted average lease expiry, quality of tenant covenant (internal assessment based on available market evidence) and age of construction

Each property asset is assessed and grouped with assets in the same or similar market segments. Information on all relevant recent sales is also analysed using the same criteria to provide a comparative set. Unless three or more sales are observed in an individual market segment (taken together with any comparable market segments as necessary), that market segment is considered inactive with the consequence that no external valuations are undertaken for those property assets. An internal valuation is completed for each asset for which an external valuation is not undertaken. Internal valuations may be based on discounted cash flow (DCF) calculations or based on cap rates and referenced to independent market data. This approach is also consistently applied to investment properties within funds managed by Goodman.

**Key assumptions for internal valuations**

Where an internal valuation can be prepared with reference to recent and reliable cap rate information, a cap rate approach is used. Whilst providing general information on markets, broad index-based valuation approaches may not be sufficiently specific to apply directly to calculations of fair value.

Alternatively, internal valuations are prepared using a DCF methodology. The DCF calculations are prepared over a 10-year period. The key inputs considered for each individual calculation (for wholly-owned investment properties as well as investment properties within funds managed by Goodman) are rental growth rates, discount rates, market rental rates and letting up incentives. Discount rates are computed using the 10-year bond rate or equivalent in each jurisdiction plus increments to reflect country risk, tenant credit risk and industry risk. Where possible, the components of the discount rate are benchmarked to available market data.”
3.5 Investment property under construction

2010 was the second year that companies had to apply the amendment to IAS 40 that includes investment properties under construction. As a result of this amendment, companies that measure their investment properties at fair value also need to measure their investment properties under construction at fair value unless the fair value is not reliably determinable. IAS 40 paragraph 53 states the following:

“If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier).”

Survey results

In last year’s survey, we noted that 26 companies that apply the fair value model for their completed investment properties also had property under construction. This year the number of companies that have disclosed investment properties under construction decreased to 24 companies, which may indicate a lower volume in property development activities.

Based on our survey results, it can be concluded that most companies are able to reliably assess the fair value of their development projects as most companies measured all their properties under construction at fair value.

Of the few companies that measure their investment properties under construction at cost, most explain in their accounting policies that such properties are measured at cost when the fair value cannot be determined reliably. However, only a few of these companies disclosed the criteria that they would meet before they change the measurement from cost to fair value. For example, Unibail Rodamco discloses that:

“Since 1 January 2009, Investment Properties Under Construction (IPUC) are covered by IAS 40 and are eligible to be measured at fair value. In accordance with the Group’s investment properties valuation method, they are valued at fair value by an external appraiser. Those for which the fair value is not reliably determinable are still valued at cost until such time as a fair value valuation becomes reliable, or until one year before the construction completion.

The development project is eligible for a fair value measurement once all three following criteria are fulfilled:

• All administrative authorisations needed to complete the project are obtained.
• The construction has started and costs are committed toward the constructor.
• Substantial uncertainty in future rental income has been eliminated.

If the time to delivery is less than one year, the project has to be taken at fair value.

The buildings under construction valued at cost are shopping centres under development, notably Les Portes de Gascogne in Toulouse – France, Benidorm in Spain and Täby extension in Stockholm – Sweden, and office developments such as Phare and Majunga in La Défense – France and Courcellor in Levallois-Perret – France.

Properties under construction are subject to impairment tests, determined on the basis of the estimated fair value of the project. The fair value of a project is assessed by the Development and Investment teams through a market-fair exit capitalisation rate and the targeted net rents at completion. When the fair value is lower than the net book value, an impairment provision is booked.”
3.6 Assumptions

Over the past years we have seen a significant increase in the quantity and quality of the assumptions disclosed by the companies in our survey. In the 2008 financial statements, 35% of the surveyed companies disclosed information on the assumptions applied. This has increased to around 54% of the surveyed companies in 2009 and to 57% in 2010/2011. Nevertheless, there is still a lot of room for improvement given the number of companies that still do not disclose any assumption at all, particularly in light of the continuing turmoil in the real estate markets and the ever increasing pressure from regulators to provide better disclosures.

Faberge disclosed qualitative information on the assumptions applied and various key valuation inputs:

“The property valuation is based on cash flow statements, in which the present value of net operating incomes during a five-year calculation period and the residual value of the property at the end of the period are calculated.

Long-term vacancies are estimated on the basis of the property’s location and condition. The valuers’ assessments of outgoing payments for running costs and regular maintenance are based on experience of comparable properties and information on historical costs provided by Faberge. Expenses are expected to increase in line with the assumed inflation rate. Ground rents are calculated on the basis of agreements or, alternatively, in reference to market ground rents if the ground rent period expires during the calculation period. Property tax is estimated on the basis of the general property taxation for 2010.

The discount rate used is a nominal required return on total capital before tax. The required rate of return is based on previous experiences from assessments of the market’s required returns for similar properties. The discount rate for Faberge’s property portfolio is 8.0 per cent (8.1) and is based on the nominal yield on five-year government bonds plus a premium for property-related risk. The risk premium is set individually based on the stability of the tenant and the length of the lease. The residual value is the market value of the leasehold/property at the end of the period of calculation, which is estimated on the basis of forecast net operating income for the first year after the calculation period. The weighted required yield at the end of the calculation period is 5.9 per cent (6.0).”

Another example of a company that disclosed comprehensive information on the valuations is Castellum. The financial statements of Castellum, a company that has provided high quality disclosures for many years, included almost four pages of such information, including an example of the internal valuation model and assumptions applied.
The assumptions that form the basis for Castellum’s valuation are shown in the table below:

<table>
<thead>
<tr>
<th>Assumptions per property category 31-12-2010</th>
<th>Office/Retail</th>
<th>Warehouse/Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real interest rate</td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Inflation</td>
<td>1.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Risk</td>
<td>5.0%-12.5%</td>
<td>6.5%-13.9%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>9.5%-17.0%</td>
<td>11.0%-18.4%</td>
</tr>
<tr>
<td>Interest rate</td>
<td>5.5%</td>
<td>5.5%</td>
</tr>
<tr>
<td>Loan to value ratio</td>
<td>65%</td>
<td>55%</td>
</tr>
<tr>
<td>Return on total capital</td>
<td>6.9%-9.5%</td>
<td>8.0%-11.3%</td>
</tr>
<tr>
<td>Weighted d:o, discounted factor year 1-9</td>
<td>8.0%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Weighted d:o, discounted factor residual value*</td>
<td>6.5%</td>
<td>7.7%</td>
</tr>
</tbody>
</table>

*required yield on total capital minus growth equal to inflation

The total change in value of Castellum’s portfolio during the year amounted to SEKm 1,222 (SEKm –1,027), corresponding to 4% (-3%) of the property value, of which approximately two thirds refers to reduced required yields and the rest to slightly improved cashflows. The change in value includes SEKm 23 due to sales of properties. The average valuation yield for Castellum’s real estate portfolio, excluding development projects and undeveloped land, can be calculated to 7.2% (7.3%). Contracted rental levels are considered to be in line with the market levels.

### Average valuation yield, SEKm

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net operating income, properties according to income statement</td>
<td>1,799</td>
<td>1,752</td>
</tr>
<tr>
<td>Reversed leasing and property administration</td>
<td>149</td>
<td>155</td>
</tr>
<tr>
<td>Net operating income, ongoing development projects</td>
<td>-2</td>
<td>-4</td>
</tr>
<tr>
<td>Properties acquired/completed as if they had been owned the whole year</td>
<td>49</td>
<td>33</td>
</tr>
<tr>
<td>Properties sold</td>
<td>-8</td>
<td>-1</td>
</tr>
<tr>
<td>Net operating income excl. leasing and property admin. for properties as if they had been owned during the whole year, excl. projects and land</td>
<td>1,987</td>
<td>1,935</td>
</tr>
<tr>
<td>Adjusted for:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Index adjustments 2011, 1.5%</td>
<td>45</td>
<td>-15</td>
</tr>
<tr>
<td>Real occupancy rate, 94% at the lowest</td>
<td>225</td>
<td>197</td>
</tr>
<tr>
<td>Property costs to a normal year</td>
<td>25</td>
<td>-</td>
</tr>
<tr>
<td>Property administration, 30 SEK/sq.m.</td>
<td>-98</td>
<td>-94</td>
</tr>
<tr>
<td><strong>Normalised net operating income</strong></td>
<td><strong>2,184</strong></td>
<td><strong>2,023</strong></td>
</tr>
<tr>
<td>Valuation excl. building rights of SEKm 496 (436)</td>
<td>30,213</td>
<td>27,742</td>
</tr>
<tr>
<td><strong>Average valuation yield</strong></td>
<td><strong>7.2%</strong></td>
<td><strong>7.3%</strong></td>
</tr>
</tbody>
</table>
Given the current economic uncertainty in many countries, the low number of transactions, increased uncertainty in valuations and the increased demand for transparency in valuation assumptions by users of the financial statements and regulators of financial markets, best practice would be to provide clear and comprehensive disclosures of the methods and significant assumptions used.

IAS 40 paragraph 75(d) requires disclosures of the methods and significant assumptions applied:

“The methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily base on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market date.”

Best practice would include the following disclosures, among others, for each operating segment:

- Passing rent per square metre
- Estimated rental value (market rent) per square metre
- Average net initial yield
- Reversionary yield
- Inflation rate
- Actual vacancy rate
- Long-term – structural – vacancy rate
- Average number of months that it would take to arrive at structural vacancy
- Long-term growth in real rental rates

In addition to the information on the key valuation assumptions, best practice would also include additional information on any valuation uncertainty. This is further described in the following section.

### 3.7 Uncertainty in valuations

Almost all of the companies that disclosed information on the assumptions applied in the valuation also included sensitivity analyses in the notes (49% of the surveyed companies). This is a slight increase compared with 2009, when 45% of the surveyed companies disclosed a sensitivity analysis.

IFRS (IAS 1 paragraph 125) requires an entity to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In most cases, the impact of a 25 to 100 bp (basis points) yield change on property value (in functional currency) has been disclosed.
Some companies also disclosed further information relating to uncertainty in the valuation and the impact of a change in valuation inputs on the valuations at the balance sheet date. Castellum included the following information:

“A property’s market value can only be confirmed when it is sold. Property valuations are calculations performed according to accepted principles and on the basis of certain assumptions. The value range of +/- 5-10% often used in property valuations should be seen as an indication of the uncertainty that exists in such assessments and calculations. In a less liquid market, the range can be bigger. For Castellum, an uncertainty range of +/- 5%, means a range in value of SEKm +/- 1,588 which corresponds to SEKm 30,180 – 33,356.

Some companies also disclosed further information relating to uncertainty in the valuation and the impact of a change in valuation inputs on the valuations at the balance sheet date. Castellum included the following information:

<table>
<thead>
<tr>
<th>Sensitivity analysis +/- 1% unit</th>
<th>Effect on value SEKm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental value SEK/sq.m.</td>
<td>+/- 2,601</td>
</tr>
<tr>
<td>Economic occupancy rate</td>
<td>+/- 413</td>
</tr>
<tr>
<td>Property costs SEK/sq.m.</td>
<td>+/- 745</td>
</tr>
<tr>
<td>Required yield</td>
<td>+/- 3,567</td>
</tr>
</tbody>
</table>

The sensitivity analysis shown above illustrates how a +/- 1%-unit change in rental or required yield affects the valuation. However, in reality, an individual parameter rarely changes in isolation with no changes in other parameters. For example, inflation may result in an increase in rental value (higher rent due to the effect of index-linked clause in the lease) as well as increase the required yield. The increases in these two parameter would have offsetting on the value of the property.”

Züblin also included a paragraph on real estate market risks in its risk disclosures. Information similar to IFRS 7 financial risk disclosure information was disclosed. Two graphs showing the sensitivity of the property valuations to a change in the discount rates as well as to changes in the market rents were also included:
**Real estate market risks**

The management of real estate market risks is one of the core competencies of the Züblin Group. Essentially, these risks are comprised of two specific categories – real estate market cycle risk and rental market risk.

Real estate market cycle risks are related to fluctuations inherent to the overall commercial real estate market and the related impact on the valuations of the Züblin Group’s Investment portfolio. These risks can be partially mitigated by the Züblin Group’s strategy of geographical diversification.

Risks in connection with a change in discount rates as well as market rents are risks that affect the entire property market. Following are two sensitivity analyses which show the impact on the property valuations in each country where Züblin is invested.

In the first analysis, the average discount rate per country is simulated in steps of +/- 10 basis points. The analysis has been capped at a maximum of +/- 40 basis points as anything more than this would not be realistic in the next 12 months. In the following graph, the bars represent the change in the valuations of the portfolios in each country. The various colors refer to the change in the basis points as is shown in the legend on the right side of the graph. The left side of the graph shows the percentage change in the value of the portfolio. For example, if the average discount rate in France is lowered by 20 basis points, the value of the portfolio increases by 2.1%.

The sensitivity analysis shows the most significant impact from the change in discount rates in Switzerland. The reason for this result has to do with the low discount rates used in the valuations in Switzerland, thereby the change in basis points has the greatest percentage effect."

![Sensitivity analysis - change in discount rate](image-url)
“In the second analysis, the impact on the valuation of the portfolios for changes in the market rent is presented. In this analysis, the change has been simulated in steps of +/- 2%. In the following graph, the left side of the graph shows the change in the value of the country portfolios. The colored bars relate to the respective percentage change in the market rents and show the related impact.

The impact of changes in the market rent assumptions is between +8.7% and -8.7% and is in a comparable range for all countries.

Rental market risks relate to the use of the property, the tenant mix, the credit standing of the tenants, the vacancy rate, the ability to increase rents, and the recover ability of running costs. Through its local internal asset management activities, the Company is constantly managing controllable risk factors, and is focused on proactively mitigating these risks where possible. Group Management meets routinely, and as part of its agenda evaluates the overall concentration risk of its tenant structure, reviews any material changes to the credit standing of its significant tenants, as well as current or pending changes to the vacancy rates in all markets. Where necessary, the Board of Directors is alerted to material changes in the Züblin Group’s specific risk profile.”
4. Acquisitions
4.1 Business combinations

In any acquisition, including that of real estate, one has to first determine whether the acquirer has acquired a business or an asset (or assets and liabilities that do not constitute a business). The revised IFRS 3 Business Combinations (IFRS 3R), which became effective for business combinations completed in financial years starting on or after 1 July 2009, has introduced a revised definition of a business compared to the previous version of IFRS 3:

<table>
<thead>
<tr>
<th>Description</th>
<th>IFRS 3R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition of a business</td>
<td>“an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return…”</td>
</tr>
<tr>
<td>“old”</td>
<td>“an integrated set of activities conducted and managed for the purpose of providing a return…”</td>
</tr>
</tbody>
</table>

The new standard seems to broaden the definition and requires more judgement to be applied. Therefore, with the introduction of IFRS 3R, many were of the opinion that more acquisitions would be considered business combinations. The determination of whether an acquired bundle of activities and assets represents a business is critical because the accounting for a business combination is significantly different from the accounting for an asset acquisition. (Please see our publication, Definition of a business under IFRS 3R, available at ey.com/ifrs).

Determining whether an acquisition is a business combination or the acquisition of an asset requires professional judgement. In general, a commercial property has to be managed to generate returns, i.e., to earn rental income. There is debate whether the acquisition has to include asset management in order to qualify as a business combination. In appendix B to IFRS 3R, paragraph B7/B8 states that a business normally consists of inputs, processes and outputs. This paragraph, however, also states that not all businesses need to have all of the inputs and processes on the date of acquisition to qualify as business combinations. There are, therefore, no bright lines and considerable judgement is required.

IFRS Interpretations Committee

During 2011, the IFRS Interpretations Committee (the Committee) received a request seeking clarification on whether an asset with relatively simple associated processes meets the definition of a business under IFRS 3R. More specifically, the question was whether the acquisition of a single investment property, together with (i) lease agreements with multiple tenants over varying periods and (ii) associated processes, such as cleaning, maintenance and administrative services such as rent collection, constitutes a business as defined in IFRS 3R.

The Committee observed that IFRS 3R and IAS 40 are not mutually exclusive. An entity acquiring an investment property should consider whether it meets the definition of a business as defined in Appendix A of IFRS 3R. The Committee noted that the guidance in paragraphs 11 – 14 of IAS 40 on ancillary services is intended to delineate an investment property from owner-occupied property, and not to delineate a business combination from the acquisition of a single asset. Investment property acquired in a business combination is recognised on the acquisition date at fair value in accordance with IFRS 3R. An investment property acquired outside a business combination is recognised at cost in accordance with IAS 40.

To avoid confusion on the inter-relationship of IFRS 3R and IAS 40, the Committee directed the staff to analyse whether a clarification can be made to IAS 40 through the annual improvements process.

In view of the foregoing, it is interesting to observe how the companies included in the survey deal with the issue.

Survey results

In 2010, 29 (76%) of the companies in our survey acquired real estate. Of these 29 companies, only five companies report one or more business combinations. This would indicate that the other companies included in our survey were of the opinion that their acquisitions of real estate took the form of purchases of assets or single asset entities that do not constitute businesses.

Of the companies in our survey, sixteen companies (42%) (2009: 8, or 21%) disclose in their accounting policies how they determine whether an acquisition constitutes a business combination or an asset acquisition. This is a significant increase compared with 2009. However, the disclosures are less extensive than expected.

Our survey results show significant differences in how companies determine whether an acquisition qualifies as a business combination, which reinforces that the determination is subject to judgement.
In its 2010/2011 financial statements, Immofinanz notes that acquisitions that do not include property management are considered business combinations. This is because Immofinanz has a property management department at its head office. This interpretation seems to follow paragraph B8 of IFRS 3R that suggests that an acquisition could qualify as a business combination by integrating the business with its own inputs and processes. Immofinanz states:

“The organisational structure required for property management is generally not taken over when the IMMOFINANZ Group acquires a company. However, these objects also need intensive and active post-acquisition management in order to optimise rental income. The IMMOFINANZ staff normally performs these management activities after the acquisition process because the necessary resources are available in the Group and, from the IMMOFINANZ viewpoint, it is more efficient to integrate the relevant property management processes into its own organization.

Against the backdrop of the management activities required to generate rental income, IMMOFINANZ views these acquisitions as business combinations in the sense of IFRS 3.”

A different view seems to be taken in the 2010 financial statements of Sponda:

“The classification by Sponda of individual acquisitions of investment properties as acquired assets is based on the view that a single property and its lease agreements do not form a business entity; the real estate business also requires marketing and development activities for properties, management of Tenancies, and management of property repairs and renovation. All these business processes and the people responsible for them are at Sponda Plc and not in the individual properties or property companies.”

This view is also shared by Corio in its 2010 financial statements:

“For an acquired company to qualify as a business the following must – at a minimum – be present at the date of the acquisition: the investment property, tenants and rental contracts, a property management organization (or a contract in which property management is outsourced to a third party).”

Kungsleden narrows asset acquisitions down to entities that have no employees or organisational resources:

“Asset deals using corporate transactions are reported as if the relevant property/properties had been purchased directly. This type of purchased enterprise normally has no employees or organizational resources, or other operations than those directly attributable to the property holding.”

In the 2010 financial statements of Icade, it appears that the legal form (either the acquisition of a legal entity or a separate asset) is decisive in determining whether the acquisition is classified as a business combination or the acquisition of an asset:

“The acquisition of the securities of legal entities, holding one or more investment properties as the principal asset is accounted for in accordance with IFRS 3 or revised IFRS 3, depending on the date of the takeover, in line with the principles described below. The acquisition of isolated assets, meeting the definition of investment properties, by a legal entity, is accounted for in accordance with IAS 40.”

Based on the findings of our survey, it appears that most companies believe that significant processes must be present at the date of acquisition in order for acquisitions to qualify as business combinations. This could be the reason why only five of the 29 entities that acquired real estate report that they entered into one or more business combinations.

Due to the judgement involved to determine whether an acquired set of activities and assets is a business and the significant implications of such determination, companies should carefully evaluate their specific facts and circumstances when applying the requirements of IFRS 3R. As stated above, further guidance from the IASB on the interrelationship of IFRS 3R and IAS 40 is expected as part of the 2011 Annual Improvements.
4.2 Goodwill recognition

Goodwill in the real estate sector typically arises on the acquisition of a business due to the following factors:

- Goodwill created by synergies of the acquired portfolio and synergies of combining portfolios (e.g., anticipated abilities of the acquired management/development team to outperform the market or achieve economies of scale)
- Goodwill arising from overpayments or errors in fair value measurement
- Goodwill created by the requirement to measure identifiable items using a measurement basis other than fair value – typically deferred tax measured at nominal value

Survey results

Of the companies in our survey, 22 companies (2009: 15) or 58% (2009: 40%) have recognised goodwill on the balance sheet. As discussed above, only five companies entered into one or more business combinations in 2010/2011. Three of the five companies noted that goodwill was mainly recognised due to recognising deferred tax liabilities at nominal value and not at fair value.

Immobinanz disclosed the following in its financial statements 2010 in relation to the deferred tax, which is recognised at nominal value:

“The acquisition and subsequent initial consolidation of project companies generally leads to goodwill because of the obligation to record deferred tax liabilities on properties that are restated at fair value. In contrast to other acquired assets and assumed liabilities, deferred tax liabilities must be recognised at their nominal value. The unequal valuation of these deferred tax liabilities normally results in goodwill as a technical figure.

The recoverable amount of the cash-generating unit comprises the fair value of the included property (properties) as determined by an expert opinion as well as the fair value of recognised deferred tax liabilities. The deferred tax liabilities are generally represented in the cash-generating unit at a recoverable value of zero. This reflects the fact that property transactions normally take the form of share deals, and the deduction of deferred tax liabilities on the purchase and sale of property companies is generally difficult or impossible to enforce in the markets where IMMFINANZ is active. As part of the impairment test, the recoverable amount is compared with the carrying amount of the included property (properties) and deferred tax liabilities.

A total purchase price of EUR 37,501 was paid for the companies acquired within the framework of the “Berlin contracts”. The preliminary initial consolidation of these companies resulted in goodwill of EUR 3.5 million, which was fully impaired.”

Corio disclosed that the goodwill it has recognised relates mainly to undiscounted deferred tax liabilities:

“The goodwill on business combinations relates mainly to the difference between the undiscounted deferred tax liabilities recognised in accordance with IAS 12 on purchase price allocation adjustments and the fair value of such deferred tax liabilities.”

Wereldhave also disclosed that the goodwill it has recognised in relation to its 2010 business combination is mainly due to the fact that deferred tax liabilities are not discounted:

“Goodwill arises mainly due to the fact that under IFRS deferred taxes are not discounted. Within the acquisition lower tax rates are reflected.”

Based on the above findings, discussions about goodwill in the real estate sector are still very relevant. While some property investors still impair a large part of the goodwill recognised upon acquisition, we urge entities to reconsider such treatment and consider applying a different method, which we discussed in our publication, *Goodwill Hunting*. This alternative method uses an adjusted amount of goodwill for the impairment test. The carrying amount of the goodwill is decreased with the amount of goodwill relating to undiscounted deferred tax liabilities relating to investment property. The net amount is then tested for impairment.

* Available at www.ey.com
4.3 Impairment of goodwill

IAS 36 requires the carrying amount of the goodwill to be compared with the recoverable amount, which is the higher of VIU and fair value less cost to sell (FVLCS). If either the FVLCS or the VIU is higher than the carrying amount, no further action is necessary as goodwill is not considered to be impaired. IAS 36 defines VIU as the present value of the future cash flows expected to be derived from an asset or cash generating unit (CGU) and FVLCS as the amount obtainable from the sale of an asset or CGU in an arm’s length transaction between knowledgeable willing parties less the costs of disposal.

Of the 22 companies in our survey that have recognised goodwill, 11 determined the recoverable amount based on the VIU method. One company used only FVLCS, one company used the higher of VIU or FVLCS and nine companies do not disclose the method used for impairment testing. In 2010/2011, five (2009: six) companies recognised an impairment loss on goodwill.

Corio is the only company that disclosed impairment testing for goodwill is exclusively performed on the basis of FVLCS. It also mentions that, for determining the recoverable amount, the fair value, instead of the nominal value, of the deferred tax liabilities is used:

“For goodwill, the method applied is fair value less costs to sell: the recoverable amount of the cash generating unit comprises the fair value of the included property as determined by external valuers as well as the fair value of recognised deferred tax liabilities.”
Additional disclosures

Based on our findings, we note that disclosures on impairment testing are sometimes very brief, or even non-existent. Due to the current economic environment, we expect that, similar to investment property valuations, there is much more uncertainty about the possible range of outcomes of impairment tests than in previous years. For users of the financial statements to be able to assess the level of uncertainty, disclosures about the valuation method applied, significant assumptions used and, possibly, a sensitivity analysis may be needed.

An example of more extensive disclosures, including a sensitivity analysis, is in the financial statements of IVG:

“The realisable value for the CGU’s IVG Institutional Funds and IVG Private Funds is determined by the calculation of their value in use. These calculations are based on medium-term budgets approved by management, which cover a period of three years. To determine the value of the annuity (value component from the end of the detailed planning period), sustainable operating cash flows are extrapolated using a growth rate for the CGUs IVG Institutional Funds and IVG Private Funds of 1.0% p.a. (2008: 1.0%). The growth rate reflects the long-term expectations for each CGU. The weighted average cost of capital (WACC) for each CGU was calculated in line with the capital asset pricing model (CAPM). The discount rates were set on the basis of market data and for the CGU IVG Institutional Fund amounted to 10.4% (2008: 11.9%) and for CGU IVG Private Funds 15.5% (2007: 15.4%) before taxes.

As the value in use exceeded the carrying amounts of the CGU’s IVG Institutional Funds and IVG Private Funds, there is no need for impairment as of 31 December 2010. An increase of the discount rate of 0.5% and a reduction of the long-term growth rate of 0.5% from which the IVG Group determines the value in use for both funds’ CGUs would not result in an impairment requirement.”

Another example of what we consider to be more extensive disclosures regarding impairment testing is found in the financial statements of Inmobiliaria.

The basic assumptions underlying the cash flow projections made in 2009 and 2010 are shown in the next table:

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projection period (years)</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Asset rotation rate %</td>
<td>10% annual</td>
<td>75%</td>
</tr>
<tr>
<td>Yield on reinvestment, % (note 4,e)</td>
<td>6%-6.50%</td>
<td>5.75%</td>
</tr>
<tr>
<td><strong>Spain</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount rate</td>
<td>7.12%</td>
<td>7.24%</td>
</tr>
<tr>
<td>Nominal growth rate (“g”)</td>
<td>1.50%</td>
<td>1.50%</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount rate</td>
<td>5.68%</td>
<td>5.94%</td>
</tr>
<tr>
<td>Nominal growth rate (“g”)</td>
<td>1.50%</td>
<td>1.50%</td>
</tr>
</tbody>
</table>
The financial projections cover a period greater than five years, as the Parent Company’s management considers that management of a rental property portfolio in the normal course of business should be based on a business cycle of at least 10 years in order to adequately manage the properties in terms of asset rotation and the reinvestment of the cash flows generated in assets of a similar nature with yields at market rates.

The Parent’s Management also considers that both the asset rotation and the nominal rent income growth in perpetuity rate (g) used adequately reflect trends in the office rentals markets in Spain and France in recent years. The Colonial Group actively manages its property portfolio and therefore considers that the asset rotation assumptions applied are reasonable for the period under consideration.

The aforementioned cash flows were discounted at a rate that takes into account the risks associated with the rentals business in Spain and France, and the quality of the Colonial Group’s asset portfolio.

The discount rate for each market is determined based on a risk-free rate (namely, the 10-year German bond yield) plus a risk premium which reflects all the risks inherent to the business and to the market in which the Colonial Group operates.

At 31 December 2010, this analysis evidenced that the rentals CGU and the associated goodwill were impaired, giving rise to a charge of 247,051 thousand euros.

The sensitivity of the goodwill impairment charge to the changes in the discount rate, the yield generated by reinvesting (both by 10bp) and the asset rotation rate (by 10%) are shown in the next table:

<table>
<thead>
<tr>
<th>Sensitivity to discount rate (+10bp)</th>
<th>(81)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sensitivity to asset rotation (10% lower)</td>
<td>(26)</td>
</tr>
<tr>
<td>Sensitivity to yield on reinvestment (10bp less)</td>
<td>(26)</td>
</tr>
</tbody>
</table>

Goodman Group also provides a sensitivity analysis:

**Sensitivity analysis**

The table below shows the impact on the impairment charge of changes in key assumptions at 30 June 2011:

<table>
<thead>
<tr>
<th>30 June 2011</th>
<th>Value in use</th>
<th>Increase pre-tax discount rate by 100bps</th>
<th>Six-month delay in development contracts</th>
<th>10% decrease in development margins in each year</th>
<th>10% decrease in property values each year</th>
<th>5% increase in forecast operating costs each year</th>
<th>25% reduction in performance fees in each year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logistics – Continental Europe*2</td>
<td>612.4</td>
<td>–</td>
<td>–</td>
<td>(110.8)</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Logistics – United Kingdom</td>
<td>84.6</td>
<td>(3.1)</td>
<td>–</td>
<td>(21.7)</td>
<td>(1.5)</td>
<td>(2.5)</td>
<td>–</td>
</tr>
<tr>
<td>New Zealand</td>
<td>55.5</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>82.2</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>China</td>
<td>41.3</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Business Parks – United Kingdom</td>
<td>153.0</td>
<td>(5.7)</td>
<td>(4.1)</td>
<td>(1.5)</td>
<td>(12.5)</td>
<td>(7.5)</td>
<td>(7.2)</td>
</tr>
</tbody>
</table>

*1 – Incremental impairment loss from a 100 basis points increase in the pre-tax discount rate.

*2 – The value in use for intangible assets relating to the Logistics – Continental Europe business is sensitive to changes in the volume of business space expected to be developed. Using development area of 0.5 million square metres in years four and five, the impairment loss to the business would be $201.9 million.
5. Financing
The continuing pressure on the financial and the property markets during 2010 and 2011 further highlighted the need for adequate loan disclosures in the financial statements. Generally, it is believed that the property sector faces very significant refinancing issues due to increased loan to value ratios and/or poor quality of collateralised properties for a very substantial portion of real estate loans, which mature and have to be refinanced in the next three years.

Paragraph 18 of IFRS 7 requires the following:

“For loans payable recognised at the end of the reporting period, an entity shall disclose:

• Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
• The carrying amount of the loans payable in default at the end of the reporting period; and
• Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.”

Almost all companies (95%) have included information in the financial statements about applicable covenants and the level of compliance as at the balance sheet date. This is a slight increase compared with last year.
In most of the cases, only general disclosures of the loan covenants are made. However, we have seen an increase in companies providing more extensive disclosures on loan covenants, e.g., covenant thresholds and the numerical results of compliance with financial covenants at the balance sheet date. The French entities in the survey all provide detailed information with respect to their covenants. An example is Foncière des Régions:

“Bank covenants
With the exception of securitised debts, the debts of Foncière des Régions, Foncière des Murs, Foncière Europe Logistique and Beni Stabili are covered by bank covenants applying to the consolidated financial statements, which, in the event of non-compliance, would be likely to constitute a case for early repayment of the debt:

- Ratio of debt in relation to the market value of the assets (LTV): this ratio corresponds to the revalued value of the aggregate of the Group’s assets, net of cash and cash equivalents and net debt.
- Interest coverage ratio (ICR): this is calculated on the basis of the consolidated results, by dividing the current operating income before the disposal of investment assets restated for allowance and reversal of provisions by the net financial costs.

These financial covenants are recorded under the consolidated Group share for Foncière des Régions and under the consolidated portion for Foncière des Régions’ subsidiaries. The most restrictive LTV covenant amounts to 70% for Foncière des Murs and 65% for Foncière Europe Logistique and Foncière des Régions as of 31 December 2010.

<table>
<thead>
<tr>
<th>LTV Consolidated debt</th>
<th>Scope</th>
<th>31 Dec 10 Covenant threshold</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accor/Jardiland finance-lease refinancing</td>
<td>FDM</td>
<td>70%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Securitised corporate loan</td>
<td>FDR</td>
<td>65%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Loan backed by Korian/Quick assets</td>
<td>FDM</td>
<td>70%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Syndicated loan backed by Beni Stabili stock</td>
<td>FDR</td>
<td>65%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Initial financing of FEL</td>
<td>FEL</td>
<td>70%</td>
<td>In compliance</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ICR Consolidated debt</th>
<th>Scope</th>
<th>31 Dec 10 Covenant threshold</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accor/Jardiland finance-lease refinancing</td>
<td>FDM</td>
<td>165%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Securitised corporate loan</td>
<td>FDR</td>
<td>190%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Loan backed by Korian/Quick assets</td>
<td>FDM</td>
<td>165%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Syndicated loan backed by Beni Stabili stock</td>
<td>FDR</td>
<td>190%</td>
<td>In compliance</td>
</tr>
<tr>
<td>Initial financing of FEL</td>
<td>FEL</td>
<td>125%</td>
<td>In compliance</td>
</tr>
</tbody>
</table>

The consolidated financial covenants of Foncière des Régions as of 31 December 2009 were 49% for the consolidated LTV (Group share) and 228% for the consolidated ICR (Group share) [not including margins on Residential sales], compared to 55.6% and 206%, respectively, as of 31 December 2009. The level of ratios of the quoted subsidiaries can be found in their respective reference documents. These accounting and consolidated covenants are also the most often applied of the specific covenants for the portfolios financed (the major part of the debt being collateralised by these portfolios).

These “portfolio” covenants (coverage ratio or, more specifically, the portfolio LTV, involve, as far as the portfolio LTVs are concerned, thresholds that are less restrictive of the Group companies than the thresholds of the consolidated covenants. Their purpose is to provide a frame of reference for the use of credit lines by correlating said use with the underlying assets given in guarantee.”
We also considered whether the companies in the survey included sensitivity analyses with respect to the applicable covenants, and noted that none of the companies provided any detailed information in their financial statements in this respect. Only Segro provided some form of sensitivity analysis with respect to one of its key loan covenants:

“The loan to value ratio (net borrowings divided by property assets) at 31 December 2010 was 46 per cent (2009: 47 per cent). The gearing ratio of the Group at 31 December 2010 was 80 per cent (2009: 91 per cent) significantly lower than the Group’s tightest financial gearing covenant of 160 per cent. Property valuations would need to fall by more than 28 per cent from their 31 December 2010 values to reach the gearing covenant threshold of 160 per cent. The Group’s other key financial covenant is interest cover requiring that net interest before capitalisation be covered at least 1.25 times by net property rental income. At 31 December 2010 the Group comfortably met this ratio at 2.2 times (2009: 2.0 times).”

We also considered whether all the companies in our survey disclosed interest rate sensitivity analyses. All but two entities presented such analyses. Most entities disclose the impact of either a 50 or 100 basis point change in the interest rate.

British land provided the following information:

“The proportion of net debt at fixed or capped rates of interest was 72% at 31 March 2011. Based on the Group’s interest rate profile at the balance sheet date a 576 bps increase in interest rates would decrease annual profits by £27m (2010: £18m decrease). Similarly, a 576 bps reduction would increase profits by £4m (2010: £2m increase). The change in interest rates used for this sensitivity analysis is based on the largest annual change in three month Sterling LIBOR over the last ten years.”
6. Going concern
IAS 1 paragraph 25 states that when management is aware, in making its assessment of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. In addition, IAS 1 paragraph 26 states that management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Lenders are continuing to rationalise their real estate loan books and a wave of commercial real estate loans across Europe are scheduled to mature by the end of 2012. The Financial Times reported on 3 April 2011:

"Up to £600bn ($967bn) of loans made to commercial property borrowers by banks and other financial institutions will require refinancing within the next two years across Europe, which could spark a crisis in the industry, as lenders take a tougher line on extensions and renewals."

Given these continuing challenges in obtaining real estate financing and refinancing, and the requirements of IAS 1, we analysed whether companies specifically addressed the risks related to going concern in their financial statements. In total, we identified 10 companies (26%) that specifically addressed the issue of going concern. In line with specific existing guidance in the UK, all British companies included in our survey addressed going concern. Of the companies in other countries in our survey, only 15% addressed the risks related to going concern in their financial statements.

We identified two entities for which the uncertainties surrounding refinancing resulted in additional disclosures and an emphasis of matter paragraph in the audit report. As an example, IVG states:

"Basis of preparation
The group could be threatened as a going concern if the following events happen concurrently: the expected sale of caverns, properties and projects does not occur as planned, the project financing mentioned above is not extended again or is extended to a substantially reduced degree only, and the covenant requirement of the above-mentioned property loan is revived and cannot be offset by pre – or post-financing of existing assets. Due to the measures introduced, going concern is taken for granted and the financial statements have been drawn up using the going concern assumption."

IVG’s auditor added the following paragraph to the auditors' report:

"We are required to advise that the continued existence of the Group as a Going Concern is threatened by risks as outlined in section 6.4 of the group management report. The section details the need for extending a project loan, the permanent regulation of a covenant and the implementation of property and cavern disposals."
An even more extended Emphasis of Matter paragraph can be found in the Auditors’ Report of Inmobiliara Colonial:

“Without qualifying our opinion, we draw attention to the fact that on 19 February 2010, the Parent entered into an agreement with a syndicate of banks and into bilateral agreements with certain financial institutions for refinancing of its borrowings, which was formalized in the “Framework Refinancing Agreement”. At 31 December 2010, all the transactions envisaged in this agreement had been performed, involving two capital increases, one of them through the contribution of loans, the conversion of convertible debentures and the other main transactions envisaged in this agreement, as described in Note 2-b to the accompanying consolidated financial statements. Once the refinancing process had been completed, the Parent’s directors prepared a new business plan which includes the turnover of certain assets of the colonial group and the performance of certain investment transactions in the future. Within the framework of this plan, the directors consider that the deferred tax assets and liabilities arising in prior years recognised by the Group for EUR 658 million and EUR 180 million, respectively, will be recovered within the envisaged legal timeframe (see Note 21).”

Segro explained that the Group had been able to negotiate a significant refinancing package during the year, which put the Group in a strong liquidity position with a favourable debt maturity profile and headroom against its financial covenants.

“Going Concern

Whilst wider economic conditions remain challenging, the Group has completed significant bank refinancing activity during 2010 and, as a result, has a strong liquidity position, a favourable debt maturity profile and headroom against its financial covenants and can reasonably expect to be able to continue to have good access to capital markets and other sources of funding.

Having made enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the Annual Report.”

Seven other entities within the surveyed group included commentary on the assumptions related to going concern. Hammerson provides the following disclosure:

“Going Concern

The current economic conditions have created a number of uncertainties as set out on page 15. The Group’s business activities, together with the factors likely to affect its future development, performance and position are set out on pages 18 to 26 of the Annual Report. The financial position of the Group, its liquidity position and borrowing facilities are described on pages 27 to 31 and in notes 18, 20 and 21 to the accounts.

The Directors have reviewed the current and projected financial position of the Group, making reasonable assumptions about future trading performance. As part of the review, the Directors considered the Group’s cash balances, its debt maturity profile, including undrawn facilities, and the long-term nature of tenant leases. After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report.”

We also observed shorter notes of a more general nature. For example, the going concern paragraph of Derwent states:

“Having made due enquiries, the Directors have reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Therefore, the Board continues to adopt the going concern basis in preparing the accounts.”

In view of the continuing tightening of liquidity in the financial markets and the real estate refinancing challenges, it may come as a surprise that there are only ten entities in our survey that specifically addressed the going concern assumptions.
7. Other issues
7.1 Deferred tax: recovery of underlying assets, amendments to IAS 12

On 20 December 2010, the IASB issued certain amendments to IAS 12 that are effective for annual periods beginning on or after 1 January 2012 (earlier application permitted). These amendments provide further guidance on the general requirement in paragraph 51 of IAS 12, which states that the measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its asset and liabilities.

The amendments provide specific guidance for investment property measured using the fair value model (IAS 12.51C). The amendments introduced the rebuttable presumption that the carrying amount of investment property measured using the fair value model in IAS 40 will be recovered through sale. (Accordingly, any related deferred tax should be measured on a sale basis.). This presumption is rebutted if the investment property is depreciable and is held within a business model where the objective it is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. Land with an indefinite useful life is not depreciable and hence this rebuttal would not apply to land. Some believed that there was lack of clarity about whether that presumption can be rebutted in other cases as well. The Committee has dealt with this matter and concluded that the presumption can be rebutted in other circumstances as well, provided that sufficient evidence is available to support that rebuttal.

The above also applies to investment property acquired in a business combination that will be measured using the fair value model after the acquisition date (IAS 12.51D).

However, the amendments do not address the issue raised in last year’s survey with respect to the disposal of “single asset” companies. In many jurisdictions, the disposal of the shares in a single asset company is either tax-free or taxed at a lower tax rate than the sale of the asset in the company. If an entity expects to sell the shares, should deferred tax assets and deferred tax liabilities be measured at the lower rate for disposal of shares?

A literal reading of IAS 12 may suggest that, when the reporting entity prepares consolidated financial statements (such that the asset held by the “single asset” entity is included in those financial statements), it is not appropriate to consider the possible tax effects of disposing of the shares in the single asset entity rather than the asset itself. This is because paragraph 51A of IAS 12 requires an entity to consider the expected manner of recovery or settlement of “the carrying amount of its assets and liabilities”. When consolidated financial statements are prepared, the asset recognised in the balance sheet is the property held by, not the shares in, the single asset entity (since the shares are eliminated on consolidation).

However, until the amendments to IAS 12 were published in December 2010, it was argued that the IASB regarded the above position as ambiguous, since it indicated during the development of the amendments that any standard replacing IAS 12 would contain guidance on determining the tax base of an asset when different deductions are available depending on whether an asset is sold separately or in a single asset entity. The IASB has not done that yet. Instead, the IFRS Interpretations Committee tentatively concluded, in 2011, that entities are unable to avoid recognising deferred tax for temporary differences relating to underlying assets even though the entity expects to dispose of its interest in the single asset entity and not the underlying asset. Therefore, entities could not look at recovery through sale of shares only, and ignore the temporary differences on the underlying assets. However, the Committee also acknowledged that there are other broader concerns relating to this issue and that these concerns need to be resolved by the Board through a wider reconsideration of the principles in IAS 12.

In view of the above, it is interesting to see what potential impact the 2010 amendments and other possible amendments made by the Board might have by looking at current practice in the 2010/2011 financial statements.
Survey results

Immofinanz discussed the impact of the amendments to IAS 12, but did not early adopt the amendments (note that the amendment had not yet been endorsed by the EU):

“In accounting for investment properties, it is often difficult to determine whether or not temporary tax differences will reverse during use or in connection with the sale of the asset. The revision to IAS 12 clarifies that the reversal generally takes place through sale. As a consequence of this revision, SIC 21 Income Taxes – Recovery of Revalued Non-Depreciable Assets no longer applies to investment property carried at fair value. The other guidelines were integrated into IAS 12, and SIC 21 was accordingly withdrawn.”

Unibail Rodamco mentioned in the financial statements that, for valuation purposes, transfer taxes are recognised based on the assumption of a direct sale and not on the sale of the entity holding the asset:

“Transfer taxes are valued on the assumption that the property is sold directly, even though the cost of these taxes can, in certain cases, be reduced by selling the property’s holding company.”

Although there is no similar disclosure for income tax, this is a good example of how the expected manner of recovery can affect the financial statements, other than the measurement of deferred tax assets and liabilities.

Wereldhave discloses that it only uses the tax rate applicable to a sale (if different than the standard corporate rate) when the sale is expected in due course:

“Applicable corporate tax rates are used to determine the deferred tax liabilities. Fiscal facilities and different tariffs applicable at the moment of sale are only taken into account for properties where sale is expected in due course.”

Similar to the prior year, Immofinanz continues to challenge whether the treatment of deferred tax liabilities for acquisitions under IFRS provides useful economic information:

“The acquisition and subsequent initial consolidation of project companies generally leads to goodwill because of the obligation to record deferred tax liabilities on properties that are restated at fair value. In contrast to other acquired assets and assumed liabilities, deferred tax liabilities must be recognised at their nominal value. The unequal valuation of these deferred tax liabilities normally results in goodwill as a technical figure.”

Kungsleden takes another approach:

“Potential deductions for deferred tax received over and above reported tax in purchased enterprises are reported as a deduction from the fair value of the purchased property both at acquisition and in subsequent reporting.”

Since the amendments will not become effective until 1 January 2012, it is not yet clear what the impact will be on the measurement of deferred tax assets and liabilities. In next year’s survey, we will assess the impact of these amendments.
7.2 Joint venture accounting

In May 2011, the IASB issued IFRS 11 Joint Arrangements. This standard supersedes IAS 31 Joint Ventures and is effective for annual periods starting on or after 1 January 2013.

Contrary to IAS 31, only two categories of joint arrangements are defined: joint operations and joint ventures. Jointly controlled assets are no longer defined as a separate category in IFRS 11. Instead, they are subsumed within the definition of joint operations. A joint arrangement is classified as a joint operation if the joint operators have rights to the underlying assets, and obligations for the liabilities, relating to the arrangement (IFRS 11.15). A joint arrangement is classified as a joint venture if the joint venturers have only rights to the net assets of the arrangement.

The correct classification under IFRS 11 is critical since the recognition and measurement requirements for the two categories are quite different. An entity with an interest in a joint operation recognises its assets, liabilities, revenues and expenses of the joint operation and/or its share thereof (which is similar to what is required for jointly controlled operations or assets under IAS 31).

With respect to a joint venture as defined in IFRS 11, the joint venturer recognises its interest as an investment and accounts for that investment using the equity method in accordance with IAS 28. Therefore, the option to recognise such an arrangement using proportionate consolidation is no longer available.

Determining whether a joint arrangement is a joint venture or a joint operation requires judgement and should be based on the substance of the arrangement and not the legal form. In addition to considering the rights to assets and obligations for the liabilities of the arrangement, many other factors need to be considered, including, but not limited to: commitments, restrictions, finance guarantees and responsibilities for losses. All joint arrangements accounted for under IAS 31 need to be carefully reassessed to determine whether they are joint operations or joint ventures under IFRS 11. It could well be that a joint arrangement classified as a jointly controlled entity under IAS 31 could be classified as a joint operation under IFRS 11.

The adoption of IFRS 11 may have a major impact on the real estate sector as joint arrangements are very common in parts of the sector. For instance, there are many jointly controlled shopping malls that are currently accounted for as jointly controlled entities using proportionate consolidation.

Another sector that uses joint arrangements extensively is the construction sector. However, in this sector there is a widespread use of general partnerships. A general partnership is a legal form under which all parties generally are jointly and severally liable for mutual commitments connected with the performance of the project. Although all factors should be carefully considered, it is likely that many of these joint arrangements will qualify as joint operations and joint operators will continue to recognise their proportionate share in the assets and liabilities, income and expenses of the joint arrangement under IFRS 11.

The common use of joint arrangements in the real estate sector is also reflected in the results of our survey. Of the 38 companies in the survey, 31 (82%) have recognised one or more joint ventures. All of these companies disclose in their financial statements that they have one or more jointly controlled entities. Of these companies 18 (58%, 2009: 64%) use proportionate consolidation and 13 (42%, 2009: 36%) use the equity method of accounting.

Although the application of IFRS 11 may have a material impact on the financial statements of companies with joint ventures, only Immofinanz disclosed information about the possible impact of applying IFRS 11. Immofinanz noted that the application of IFRS 11 would have a significant effect on the consolidated financial statements.
7.3 Investment property transfers

Current economic conditions have resulted in developers and holders of investment properties retaining property for longer periods, making consistent classification decisions more relevant. In these circumstances, it would be interesting to determine if many transfers have occurred, also taking into account the restrictions with respect to transfers in IFRS.

Paragraph 57 of IAS 40 sets out the conditions when a property shall be transferred from inventories to investment property:

“Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:
(d) commencement of an operating lease to another party, for a transfer from inventories to investment property.”

We believe IAS 40 paragraph 57 establishes a guiding principle regarding transfers to, or from, investment property based on whether there is a change in use and provides a list of examples of evidence. However, some interpret the list in IAS 40.57 as exhaustive, given the reference to “evidenced by” in that paragraph, and, therefore, apply this guidance in practice in a very narrow and rigid sense. However, in our view, it would seem inconsistent to prevent a transfer to investment property for a property that meets the definition of an investment property. IAS 40.5 defines investment property as:

“Property held to earn rentals or for capital appreciation or both, rather than for:
• Use in the production or supply of goods or services or for administrative purposes; or
• Sale in the ordinary course of business.”

If it is determined that there is a change in use, the word “shall” in IAS 40.57 indicates that the entity is required to transfer the property to investment property.

The commencement of an operating lease is generally evidence of a change in use. However, even in the absence of the commencement of an operating lease, there may be other circumstances that provide evidence of a change in use. An entity’s intent alone to change the use of a property is not sufficient evidence; actions toward affecting a change in use must have been taken by the entity to support that such a change has occurred. The assessment of whether a change in use has occurred is based on an assessment of all the facts and circumstances. If it is determined that a change in use has occurred, the entity is required to transfer the property from inventory to investment property. We would generally conclude that there is sufficient evidence for a change in use from inventory to investment property if the following criteria are met:

- The entity has prepared a business plan that reflects the future rental income generated by the property and is supported with evidence that there is demand for rental space.
- The entity can demonstrate that it has the resources, including the necessary financing or capital, to hold and manage an investment property (which requires different skills than developing a property for third parties). If the entity also owns other investment property this could be more easily demonstrated. However, if this property would be the entity’s only investment property, it may be harder to demonstrate.
- Any change in the function of the property is legally permissible. That is, the entity has obtained permission from relevant authorities for the change in function. In cases where the approval of the change is merely perfunctory (i.e., not at the discretion of the authorities), the entity’s request for permission may be sufficient evidence.
- If the property must be further developed for the change in use, development has commenced.
Survey results

Three companies reported transfers from inventories (IAS 2) to investment property (IAS 40). Five companies had transfers from own-use property (IAS 16) to investment property (IAS 40).

Sponda explicitly mentioned in its financial statements that its trading properties can become investment properties:

“When a trading property becomes an investment property that is measured in the balance sheet at fair value, the difference between the fair value on the transfer date and its previous carrying amount is recognised in the profit or loss under profit/loss on sales of trading assets.”

Transfers that occurred in 2010 were described as follows:

“Properties classified at the time of the acquisition as trading assets that had been leased and that had not been sold in time typical for trading assets, have been reclassified as investment properties.”

IVG reported a reclassification from assets held for sale to investment properties:

“The real estate portfolio in Nuremberg which was reported as a disposal group of the IVG Real Estate segment in the previous year, and the investment property of the Real Estate segment in Munich and Berlin, classified as assets held for sale in the previous year, were reclassified back to investment property due to the intention to sell being abandoned.”
8 Sustainability reporting
The United Nations Environment Programme (UNEP) Sustainable Buildings & Climate Initiative reports that buildings represent 40 per cent of global energy use and one third of global greenhouse gas (GHG) emissions. Reducing GHG emissions in buildings is widely recognised as the least expensive way to mitigate impacts. The construction and real estate sectors have the potential to play a significant role in the response to climate change.

An increasing number of investors are embedding sustainability criteria in their investment policies and lessees are requiring buildings to be state-of-the-art when it comes to energy consumption reduction. Energy efficiency is a priority of the European Union. Also, FIEC (The European Construction Industry Federation) has put sustainable construction very high on its agenda. It has recommended ten principles of sustainability, among which are minimising waste, environmental classifications of buildings and use of environmentally “friendly materials”, social responsibility and optimising working conditions.

On the reporting side, the Global Reporting Initiative (GRI) has issued its Reporting Framework, which sets out the principles and performance indicators that organisations can use to measure and report their economic, environmental, and social performance. The cornerstone of the GRI Reporting Framework is the Sustainability Reporting Guidelines. The GRI has issued a sector-specific supplement for the real estate sector, called The Construction and Real Estate Sector Supplement (CRESS). The CRESS is intended for companies that:

- Invest in, develop, construct, or manage buildings
  And
- Invest in, develop or construct infrastructure.

The sector supplement describes sustainability disclosures and performance indicators that are important or unique to the construction and real estate sectors. These focus on:

- Product and service labelling, including building and materials certification
- Building energy intensity
- Water intensity
- GHG emissions relating to buildings in use
- Management and remediation of contaminated land
- Labour health and safety topics
- Resettlement of local communities
- Contractor and subcontractor labour issues

Survey results

Companies are responding. For example, Kungsleden states in its annual report:

“Environment

Sustainability issues have grown to become a natural component of Kungsleden’s operations, and this work deepened further in 2010. Environmental work is not a short-term initiative confined to isolated years, but a strategic, goal-oriented process. This has been corroborated by Kungsleden being approved for inclusion in all Swedbank Robur’s sustainability funds, and for the second consecutive year, being recognised among the leading property companies in environmental organisation Carbon Disclosures’ evaluation of listed companies in the Nordic region. In 2010, Kungsleden achieved 68 (67) of a possible 100 points on the Carbon Disclosure project. For its environmental work to pay off, Kungsleden’s organisation must be responsive to, and interested in, finding new opportunities. In the year, Kungsleden’s environmental work featured clear measures that produce measurable results. Staff have a big commitment to environmental issues. New ideas are evaluated, while simultaneously, there is a sharp focus on selected target segments.

Over and above work on collective environmental goals, a series of activities were conducted such as: participation in the WWF Earth Hour campaign, an environmental training day for all staff at the Swedish Natural History Museum and targeted training in energy-saving for technical managers. Kungsleden also developed web-based tools for tenant energy savings on its website, www.lokalamojligheter.se and arranged an internal climate change week, including challenges and activities to spread information on climate issues.”

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The chart below summarises the number of financial statements in our survey that include some form of sustainability reporting.

<table>
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<th>Sustainability reporting</th>
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<tr>
<td>Yes</td>
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<td>31</td>
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Our survey shows there are significant differences in the level of detail that is provided and where in the financial statements/annual report the sustainability information is included. In most cases, the information is incorporated within the Management Discussion & Analysis or a similar section. However, some entities have issued a separate sustainability report. IVG, for example, has a sustainability and corporate responsibility report on its website. The report itself is not based on the GRI Reporting Framework, but does provide considerable detail and KPIs with respect to IVG’s performance.

In addition, Hammerson provides sustainability KPIs. It states:

“This is our third year of reporting using the Global Reporting Initiative (GRI) guidelines. As in previous years, we are aiming to achieve GRI Level B. We also participate in indices such as the DJSI, FTSE4Good and have published our response to the Carbon Disclosure Project and comply with the Green Property Alliance Common Metrics.”

Hammerson also reports its performance on climate change, energy efficiency and resource use:

- “Since our baseline year of 2006, we have reduced the carbon emissions (expressed in CO2e) from landlord shared services by 21% (excluding Highcross) for UK shopping centres, 13% (excluding O’Parinor) for French shopping centres and by 13% for UK offices, when normalised on a like-for-like basis.
- Our targets represent 48% of our total carbon emissions; our total carbon footprint for 2010 is 65,312 tCO2e.
- Waste: The proportion of waste recycled, reused or composted (through onsite and offsite segregation) reached 55% for UK shopping centres, 29% for French shopping centres and 54% for UK offices. We have reset our long-term target for France from 50% to 75% recycling by 2013. This change is to align with the new French Government target of 75%.
- Water: We completed water audits in the UK and France, which have enabled us to set a long-term measure of a 12% reduction by 2015 based on a 2010 baseline, for all managed shopping centres in the UK and France. We have chosen a different approach to setting a reduction for UK offices due to the cyclical nature of our office portfolio. Therefore our measure is to reduce consumption and ensure all properties meet good practice benchmark by 2013 and best practice by 2015.”

The vast majority of the companies in our survey, however, have yet to report sustainability performance. This is consistent with findings of the European Public Real Estate Association (EPRA), which noted that around two-thirds of listed property companies in the EPRA European index have yet to disclose their sustainability performance. Given EPRA’s objectives to establish best practices, undoubtedly, this situation will change with the introduction of EPRA Best Practice Recommendations, September 2011 for sustainability reporting.

2 www.epra.com/main-news-tree/pr-template4/
One of the new companies in our survey, Brookfield, makes a clear commitment to sustainable development in its financial statements, which includes a corporate responsibility report:

“LEED Gold Certification Development Pledge

In addition to ownership and management, Brookfield is a developer of premier office properties that define the skylines of major cities throughout the United States, Canada and Australia. We have pledged to build all new developments to a minimum standard of LEED CS Gold. Our two most recent developments – Bay Adelaide Centre West in Toronto and Bankers Court in Calgary, both completed in 2009 – have subsequently received LEED CS Gold certification. Bankers Court was the first Canadian office building to garner this distinction, further explained in a case study below. Bay Adelaide Centre West was certified LEED CS Gold in June 2010. The tower – the first new office building in Toronto’s financial district in 17 years – uses innovative design technologies and conservation strategies which translate into an estimated 20 percent energy savings for tenants relative to comparable buildings.

Looking at future development, Brookfield’s 16-milion-square-foot development pipeline (1.48 million m²) includes 12 centrally located sites in the downtown cores of New York, Washington, DC, Houston, Denver, Toronto, Calgary, Ottawa, London and Perth. It is intended that these sites will be developed and designed to a minimum standard of LEED Gold or market equivalent (e.g., 5-Star Green Star rating in Australia, further explained below) when conditions are conducive to new development.”

Those entities that provide sustainability information often refer to LEED (Leadership in Environment and Energy Design), BREEAM (Building Research Establishment Environmental Assessment Method) and Green Buildings when discussing their efforts in this respect. Another recurring topic is the Carbon Reduction Commitments. We think that this is one of the more frequently addressed topics because it is one of the more mature areas of reporting, and an area for which robust monitoring mechanisms have already been established.

Rating systems

One of the challenges for companies in the sector to come to a common reporting is the jurisdictional differences between the various environmental rating systems for buildings. The LEED system has been developed by the US Green Building Council, BREEAM was established in the UK by the Building Research Establishment and Green Star by the Green Building Council of Australia. In our view, it would be beneficial for the real estate sector if the various jurisdictional rating systems would start a process of aligning the requirements, so that an investor could easily compare a LEED Gold development in Canada to a 6 Green Star building in Australia and a BREEAM Good rated development in the UK. Obviously, there are similarities between the various standards, and both LEED and Green Star have been derived, in part, from the BREEAM standard, but, in our view, aligning the various rating systems would benefit all of those involved in the real estate sector.
9. Conclusions and looking ahead
For financial year 2010/2011, we have seen improvements in disclosures and the level of detail provided in some uncertainty and sensitivity analyses. Nevertheless, there is still room for significant improvement as demonstrated by the fact that 40% or more of the surveyed companies neither disclose the significant assumptions underlying real estate valuations nor a sensitivity analysis. Also, the amount of information provided on debt covenants and going concern assumptions suggests there is still considerable room for improvement. At the time of publication of this survey, there is uncertainty in the real estate markets with decreasing transaction volumes, worsening occupier fundamentals and high restrictions on real estate financing. At the same time, we also observe that regulators are taking more and more interest in adequate disclosures with respect to valuation assumptions, valuation methods and valuation sensitivity. We encourage preparers of financial statements to monitor these developments, and to closely observe and learn from best practices. Some of these are included in our survey results.

Going forward, the sector may face significant issues with the adoption of IFRS 10, IFRS 11, IFRS 12 and IFRS 13, compliance with EPRA's best practice guidelines for sustainability reporting, and the upcoming changes to revenue recognition and lessor accounting. In addition, the adoption of the guidelines of the GRI poses its challenges. Some of the issues that will evolve are:

- Will the new consolidation requirements (IFRS 10) and changes in accounting for joint arrangements (IFRS 11) fundamentally change the balance sheets of real estate entities?
- Will IFRS 12 Disclosure of interests in Other Entities again increase the level of required disclosure information?
- Will IFRS 13 Fair Value Measurement lead to changes in fair value accounting or will it affect only disclosures?
- In the context of IFRS 13, are property valuations level 3 or level 2? And will the concept of highest and best use lead to changes in fair values?
- Will real estate entities continue to be provided relief from applying the new lessor accounting model?
- Will the real estate sector be affected by new accounting requirements for lessees?
- Will the proposed new standard on revenue recognition have any impact on the real estate sector? Or will it only impact the construction and development business?
- How will ongoing discussions on deferred tax accounting and business combinations impact the sector?
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