The Association of Real Estate Funds
Head Office: 3 Waterhouse Square
London EC1N 2SW
+44 (0)20 7269 4677
info@aref.org.uk
www.aref.org.uk

Financial Reporting Council
8th Floor, 125 London Wall
London EC2Y 5AS

Response by email: stewardshipcode@frc.org.uk

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FRC – UK Stewardship Code Consultation

We, the Association of Real Estate Funds[1] (AREF), have read with interest the UK Stewardship Code ('Code') Consultation. One of AREF's main aims is to promote transparency and therefore we fully support the Code.

We have provided our response below in respect of organisations' reporting against the Code for their real assets. We appreciate that the Code is meant to be asset agnostic, but we believe that the Code is still written with mainly listed equities in mind. We would like to ensure there is appropriate guidance provided for organisations reporting against their real assets and to this end we are willing to assist FRC to achieve this. We would like to make it clear that when we refer to real asset investments, we don't just mean direct investment in buildings and infrastructure. We include in this, indirect investments, for example in real estate funds, REITs and private equity debt. All of these have their own nuances in respect of stewardship reporting.

If you would like to discuss any aspect of our response, please contact Jacqui Bungay, Head of Policy at AREF, or myself (policy@aref.org.uk),. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, we are always willing to assist the FRC by sharing this wealth of knowledge and experience.

Paul Richards

CEO, The Association of Real Estate Funds

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

AREF
The Association of Real Estate Funds

Definition of Stewardship

Q1. Do you support the revised definition of stewardship?

We support the revised definition and the supporting language alongside it. From our point of view, this definition has evolved to now being more applicable for investment in a wider range of assets including real assets. We totally agree with changing the focus from 'leading to sustainable benefits' to 'creating long-term sustainable value'.

Process for reporting

Q2. Do you support the proposed approach to have disclosures related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?

We welcome the proposal to report on 'Activities and Outcomes' annually and only having to update the 'Policy and Content Disclosure' when there are significant changes. As well as reducing the amount of reporting each year, we believe that having two separate types of reporting may make it easier to split the reporting within organisations helping to make reporting against the Code less of a burden.

Our members have advised us that they have found the current stewardship reporting onerous to complete and they do wonder if most investors and other stakeholders read all the way through the long reports produced. Splitting the reporting will hopefully produce shorter and more focussed annual reporting.

We appreciate that a 'significant change' may vary from firm to firm. However, to ensure there is consistency in reporting, we would ask for at least some examples of when the 'Policy and Content Disclosure' would be expected to be updated due to a significant change.

Principles

Q3. Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?

We fully support the Code offering 'how to report' prompts and guidance for different types of assets. Private equity, including real estate and infrastructure, is a growing asset class and therefore there needs to be guidance on how these types of assets apply stewardship. We agree reporting shouldn't be a tick box exercise; however, guidance should provide clarity on how to report for a wide range of real assets including direct property, real estate funds, REITs and private equity debt. This should ensure that there is consistency in reporting across different organisations, enabling investors and other stakeholders to compare the stewardship for similar assets across organisations.

We would like to point out that we believe that some areas of the consultation are too focused on investment in listed equities. For example, in paragraph 42, when it talks about engagement, it refers to engaging with companies and fund managers. For direct holdings in real estate, engagement would be with property managers, tenants, service providers and other stakeholders.

In Appendix D, it does acknowledge that the type of engagement and range of interactions may vary depending upon the assets held and the 'Questions to consider' are general enough to be appropriate for most, if not all, asset classes. However, there is a general assumption that engagement will be with companies and will relate to being a shareholder. For real assets, the engagement may be with a fund manager, property manager, tenants, suppliers and communities in the vicinity of a direct property holding. We would like guidance and language to be applicable for a wider range of asset classes.

One form of collaborative engagement is engaging with other entities through trade bodies such as AREF. This isn't mentioned in Appendix D, and we believe that the benefits of being a trade body member and participating in the work of appropriate trade bodies is an important and effective stewardship tool and should be included as an example in the guidance for the proposed Principle 3. One of the main purposes of AREF is to ensure its Fund Members uphold the highest standards of transparency, accountability and governance. For many years AREF has asked its Fund Members to abide by a Code of Practice. After a comprehensive review, AREF has recently replaced this with a Charter of 10 Guiding Principles. This provides Fund Members with a practical framework to guide them in delivering excellence across all aspects of fund management. (The AREF Charter).

It mentions in the section 41 of the consultation that the UK Stewardship guidance will support reporting across assets classes. AREF would be happy to work with the FRC on developing, within the UK Stewardship guidance, narrative and examples relevant for real estate as an asset class and also reviewing it on an ongoing basis to ensure the guidance stays relevant.

Q4. Do you agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some which are only applied by those who invest through external managers?

Yes, we agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some only applied by those who invest through external managers.

We would like to point out that an asset manager with full investment discretion can exercise more stewardship engagement than one with no discretion. The guidance should acknowledge that the asset manager of a non-discretionary fund has no discretion over the fund's investment strategy and therefore cannot make investment decisions without approval of the owner of the fund.

Also, in relation to real estate, it should be noted in the guidance that the type of tenancy agreement and lease that is in place can make a difference to how stewardship can be applied by the asset owner. An example of this is where an asset is a building with a Full Repairing and Insuring (FRI) lease and therefore the tenant has responsibility for all external and internal maintenance, decorations and repairs. In this case, the asset owner may be more limited in the stewardship that they can apply compared to a property where they manage all the maintenance and repairs.

We welcome the proposal that 10% or more of a signatory's assets under management is the threshold to determine which Principles apply. For example, a fund which invests directly into property may have a small investment in indirect real estate assets to enable it to manage its liquidity or while it is waiting to find a suitable property to buy. To have to report on this small indirect holding would increase the burden of reporting needlessly.

We would like to point out that some Principles are not appropriate for some asset classes, and this should be reflected in the guidance. We do not believe that the proposed Principle 4 'Exercising rights and responsibilities' is applicable when investing directly in real assets. We assume it would be fine to say this Principle is not applicable when completing stewardship reporting and this should be made clear in the guidance.

Q5. Do the Principles of the updated Code better reflect the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties?

We agree when investing indirectly in real assets, for example through real estate funds or REITs, stewardship reporting should focus on oversight of the activities and initiatives being undertaken by the manager of the fund or REIT.

Q6. Do you agree that the updated Service Providers' Code should have some Principles that are applied only by proxy advisors, and some that are only applied by investment consultants?

No comment

Q7. Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?

We support the streamlining of the Principles to reduce signatories' reporting.

In respect of the proposed Principle 3 'Engagement', our members require more clarity on the type of engagement fund managers of direct real estate assets should report on. As mentioned in our response to Q3, the example in Appendix D is too focused on investment in equities. Without more specific guidance it is open to different interpretation of which parties, that real estate fund managers engage with, should be included in the fund managers reporting. Real estate fund managers engage with property managers, tenants, communities in the vicinity of the properties and a wide range of service providers. Also, as oversight and management of external managers and service providers would be reported under the proposed Principles 5 and 6, we would like clarity on whether engagement with these third parties should not be included in reporting for the proposed Principle 3.

In Appendix B, the Proposed updated UK Stewardship Code, it classifies service providers as proxy advisors and investment consultants. Proxy advisors are not relevant for real assets as an asset class, and in addition to investment consultants, there are a wide range of other service providers required when investing direct in real assets, such as surveyors, property valuers, solicitors, project managers and development partners. Our members would like guidance on whether they should report on engagement with all service providers or if there are key service providers they should consider for their reporting.

When reporting under the proposed Principles 5 and 6 we believe that property managers should be considered as service providers, and not external managers. However, some of our members have asked for clarification on this.

Guidance on the type of case studies that should be provided would also be welcomed. Should the case studies include routine engagement or one-off projects and initiatives or both?

Positioning

Q8. Should signatories be able to reference publicly available external information as part of their Stewardship Code reporting, recognising this means Stewardship Code reports will no longer operate as a standalone source of information?

We welcome referencing publicly available external information as part of the Code reporting. We believe that this could reduce some of the burden of reporting.

We would like to see guidance on the type of external information that could be referenced and how this could be incorporated in the Code reporting. This would help to ensure there is consistent reporting across different organisations.

Timeline and implementation of an updated Code

Q9. Do you agree with the proposed schedule for implementation of the updated Code?

We agree with the proposed schedule for implementation of the updated Code.