INVESTMENT & PENSIONS EUROPE

China closer to REIT debut

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Is China on the cusp of launching its first-ever REIT? ***Tsering Namgyal*** *reports on what could be the birth of a massive market.*

Although the Chinese government is yet to officially announce it, media reports have said that the PRC authorities approved what looks like China's first REIT back in January, a move that industry participants have welcomed as a positive development.

China's first listed REIT "will bring many positive benefits to the country's property market", says Peter Verwer, recently appointed CEO of the Asia Pacific Real Estate Association (APREA), an industry body with chapters across eight Asian nations.

"The classic benefits of REITs are increased liquidity, diversification, transparency and long-term, stable performance," says Verwer. "For China, an emerging REIT market can boost the capital needed for development projects, including social infrastructure, such as low-cost housing."

For China's maiden REIT, the authorities have reportedly approved a proposal by China's largest brokerage house Citic Securities to float a REIT backed by two office buildings worth a combined ¥5bn (€36m)in Beijing and Shenzhen. Citic Securities reportedly owns both buildings.

UBS Global Asset Management also said it launched a fund last year to invest in Shanghai's public rental homes, the first investment product of its kind in China. It will convert into a publicly listed REIT when the regulator allows it, according to media reports.

Although the Chinese REIT is a prototype, it represents a positive step to a more fully-fledged model that can be offered to the broader market in the future, according to Verwer. "APREA will continue to work closely with the Chinese government in developing a world class REIT regime that meets China's long-term goals," he says.

The move by Beijing to approve REITs comes nearly 10 years after a pilot programme for REITs was first discussed as early as 2004. It has taken a long time for the Chinese government to give a green light to the product, which has gained much traction in Asian countries such as Japan, Singapore, Hong Kong and Malaysia within the past decade.

The gradual pace of the Chinese REIT market development shows that the PRC government is "taking a measured approach to encouraging REITs", Verwer says. "In most countries, REITs follow a standard evolutionary pathway that can take a decade to reach maturity. China is at the beginning of this journey."

It is imperative to establish “a strong and robust investment asset class that will meet China’s long-term needs,” Verwer says, rather than just copying and transplanting models from other countries. Indeed, unlike other countries, China’s first REIT will be privately placed to institutional investors, and will not be listed, although this could change as the markets become more mature.

However, the growth prospects for the Chinese real estate industry are strong. “Clearly, the opportunities to develop a prosperous REIT market is enormous,” says Verwer.

Given the rapid growth of the China’s economy, it is not surprising that by 2021 its real estate market is expected to account for roughly 20% of the global real estate value, up from 7% currently, according to APREA.

Meanwhile, China is expected to be the largest contributor to global growth of institution-grade commercial real estate within the next decade, based on forecasts by Pramerica Real Estate Investors.

There are, however, challenges facing the Chinese REIT market. Most emerging REIT markets tend to follow the “same evolutionary path; they also face similar hurdles”, Verwer says. More specifically, it is important to ensure that “REIT laws promote transparency and operate under sensible tax rules, and double taxation should be avoided.”

According to a KPMG study, tax incentives seem to have played a key role in developing the Singaporean REIT market.

On the whole, according to a survey conducted by Ken Atchison of Atchison Consultants for APREA, Australia, Singapore, Japan and Hong Kong have the most favourable regulatory regimes among Asian markets.

Meanwhile, China must keep in mind, Verwer says, “not to straightjacket REIT platforms with onerous restrictions on gearing and eligible business activities”. He adds: “As with so many growth opportunities, the goal is to strike an appropriate balance.”

REITs, in general, would bring many benefits, including fostering the growth of new Chinese enterprises that generate jobs and produce economic growth, such as property management businesses, he says.

In time, China-based REITS can also help bring the benefits of property ownership to Chinese individuals and families. This is particularly relevant to societies with ageing population challenges, as REITs can offer a platform for generating wealth that reduces the cost of maintaining ever more expensive social welfare safety nets.

REITs provide companies with greater access to capital markets than under private ownership. REITs also demand greater transparency and enhanced governance through public disclosure requirements and bring lower trading costs and lower cost of capital.

The Asian REIT market has grown significantly over the past couple of years. As of December 2013, Asia REIT market capitalisation stood at $138bn, which is up from $68.5bn as of the end of 2007. As of 2013, Japan had the largest market share ($71.1bn), followed by Singapore ($40.3bn), Malaysia ($6.8bn) and Taiwan ($2.8bn).

It seems that China’s REIT market is on the cusp of a change. It is coming at a time when the market is rife with stories about the challenges facing the real estate market in China and, according to more pessimistic views, an impending burst in the property market.

China's housing price correction steepened in May, with only 15 cities reporting a month-on-month increase in prices for new homes, down from 44 cities in April. In half of the 70 surveyed cities, first-hand real estate prices fell, up from just eight in April. This means that home prices fell on a nationwide basis.

The good news is that the housing ministry is reportedly encouraging the market forces to correct the supply-demand imbalance, which is probably healthier for the long-term health of the industry.

Indeed, under normal circumstances, it is often crises that are instrumental in bringing lasting change in most systems and the same, it seems, holds true for REITs. "The now mature REIT markets found in the US and Australia came about as a result of major real estate and economic crises," Verwer says.

If this is true, then perhaps the current travails in the property market might look like an opportunity to jumpstart China's fledgling REIT market.