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City & Country: Guidelines to improve REIT management

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THE Asia Pacific Real Estate Association (APREA), which represents and promotes real estate investment trusts in Asia-Pacific, says REITs in the region will see an improvement in their operations and management if regulations are standardised.

The study, entitled "The impact of REITs on Asian economies", was conducted to build a deeper understanding of the securities and to boost the markets in Asia-Pacific.

The study found that investors prefer to invest in REITs that have better legislative support, tax regimes and investment flows. Many governments in the region fear a loss of tax income if they commit to the suggested regulations, but the study shows that they actually result in higher tax revenue.

It says investors like countries such as Singapore, Hong Kong, Japan and Australia because their markets are transparent, thanks to supportive legislation and good corporate governance. "Their taxation regimes simply put REITs on a par with direct real estate and the resultant increased economic activity and job creation far outweigh any impact of tax leakage. Asian REIT markets are expected to continue their trajectory of healthy growth with Singapore, Hong Kong and Japan seen as the most welcoming to market development and the preferred markets for investors."

What is critical to the REIT market is support from the government, which can be through the enactment of a positive legislative framework, the study points out. "Some Asian government view REITs as a vehicle that could be used to bail out owners of distressed real estate investments at the expense of retail and unsophisticated local investors rather than as a way of providing investors with high-quality access to investment-grade real estate.

"Furthermore, some Asian governments limit foreign ownership of real estate, hampering the development of a REIT market that taps international capital. Although there might be some tax leakage in direct property-related income tax due to the introduction of the regime, the results of the APREA survey suggest that the net impact on taxes collected by governments is positive, thanks to the increased activity in the real estate sector, generating multiple additional sources of tax revenue like transaction levy."

Referring to the KPMG 2010 report, the study says the Singapore government's decision to provide incentives for REITs has played a significant role in the growth and development of the market in the city-state. "The raised profile of Singapore's capital markets and job creation are the result of an improved and incentivised REIT market. In short, the overall economic benefits enjoyed by Singapore far outweigh the tax leakage."

The study also shows that most respondents intend to increase their allocation to Asian REIT markets over the next three years with a bias towards Australia, Singapore, Japan and Hong Kong.

It says a well-supported REIT market can benefit a country's economy by offering institutional and individual investors exposure to income-generating real estate, attracting capital, providing a relatively low cost of capital and improving market transparency.

Victor Yeung, chief investment officer with Hong Kong-based asset manager Admiral Investment Ltd, also researcher for the study tells City & Country that due to a lack of understanding of REITs, people often associate their returns with those from equities and bonds, which are high-risk securities, and tend to question their viability as investment vehicles.

"Investors often conclude that REITs are similar to equities, but they are not. REITs have lower volatility and higher returns than other investment vehicles for property investment. This study shows that REITs can improve a country's economy and act as better investment vehicles that give more stable and higher returns."

APREA is the industry body for the suppliers and users of capital in the real estate sector as it promotes the Asia-Pacific real estate asset class, encourages greater investment in the region's real estate through the provision of better information to investors, enhances regional and global networks for capital suppliers and users and is a representative of the property sector to governments and regulators to improve the commercial operating environment for its members.

According to its former CEO Peter Mitchell, the study will be presented to countries, especially those that have yet to manage REITs, such as India and the Philippines, for a better understanding of the REIT industry.

"We're doing a lot of work to propose this idea to India and the Philippines. Although this report was not ready a few months ago, the conclusion was presented to their governments and regulators.

"One of the issues addressed in the study is standardised regulations in Asia-Pacific, where the valuation standard varies enormously. The study highlights that valuation is not the only thing that matters, but also corporate governance.

"The objective of the handbook is to apply best practice recommendations that should be adopted for region-wide standardisation."

Mitchell adds that the study will also be presented to China as there has been talk of REITs for the past five years. The China government has plans to make REITs a part of its cooling measures. "This study will be important to them as they implement REITs as it will serve as a guideline."

More than 1,000 REITs and their investors from Asia-Pacific participated in the study, which was recently commissioned by APREA. With such participation, the study can help REITs and regulatory bodies understand investors' views and the industry as well.

Yeung summarises that investors are looking for operational flexibility while maintaining restrictions on finance for better dividend payouts.

"Investors are looking for flexibility on the operational side as not all of them are looking for the same thing. Some may be looking for developments while others may not. Yet on the financial side, investors still want restrictions on finance as dividend payout is affected. Investors agree that the current restrictions should not be tempered.

"There are a couple of successful REIT markets around the world that have no debt limits, where the market has to adjust to what is considered okay. Although a non-existent debt limit is a possibility, what we found is that people are not expecting the government to change that."

MREITs and their prospects

Malaysian real estate investment trusts (MREITs) did not use to be as popular as they are today. Called property trusts, they did not gain in popularity until 2005 when they were "relaunched", after Securities Commission Malaysia drew up a framework for them. The market capitalisation of REITs was only RM365 million when they started compared with RM6.8 billion as at Dec 31, 2013.

In 2008, their market cap fell to RM971 million from RM1.2 billion the year before because of the global financial crisis. "A fall in the MREIT market during the global financial crisis resulted in a fall in their market cap," says Kevin Toohey, general manager of Atchison Consultant, an Australia-based property consultant group. Atchison Consultant was a part of the research team for the study.

"The advent of the global financial crisis in 2008 resulted in significant falls in equity and REIT markets across the globe, including Malaysia," he says. "MREITs saw negative returns during the period, but they have since mostly experienced positive returns."

According to Datuk Stewart LaBrooy, CEO of Axis REIT Bhd and chairman of APREA, MREITs have recorded the highest growth rates in Asia since 2007. "From a very low level in 2007, market cap has accelerated to RM1.2 billion, which is a rise of 450% in six years. We also note a sharp rise in the level of understanding of the investment community, both institutional and public, of how the inclusion of REITs in their investment portfolios can enhance returns."

Technically, REITs can expand their portfolios by 20% per annum. A REIT with a market cap of RM4 billion could purchase RM1 billion worth of assets annually, LaBrooy adds.

However, despite the capability of REITs to expand their portfolio by such magnitude, LaBrooy feels that assets of such size are not readily available in the Malaysian market. This will slow down the growth of the larger REITs this year, he says.

When asked which part of the study has been shown to the Malaysian authorities, LaBrooy says the findings will be shared with the SC soon after the APREA Leaders Forum in Hong Kong.

"It is part of our ongoing engagement with the regulators, which is one of the key mandates of the association. The findings are interesting in that there appears to be a shift in sentiment towards stapled and internally managed REITs. In addition, investors want to see REITs involved in some form of development in their mandate," he adds.

"I believe that they feel our regulatory environment is better than that of many other countries, although it still can be improved to match Singapore's, hence the neutral view. For example, dividends for individuals are still taxed in Malaysia but are tax-free in Singapore."

On the outlook for MREITs this year, LaBrooy says there are challenges ahead as there has been a sharp compression in yields and a corresponding rise in asset prices, making accretion difficult.

"This is where the strength of the management of each REIT comes into play. The stronger management teams will be able to keep growing their portfolios and distributions to unit holders despite the current difficult acquisition environment."

The team that presented the study recently … (from left) Yeung, Mitchell, LaBrooy and Toohey

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