Finance Asia

REIT regulation

The Philippine REIT experiment will start with Ayala Land, but challenges lay ahead

After years of regulatory horse trading with the market, one of the Philippines' highest profile companies is set to list the country's first ever REIT. In what is seen as a huge shift in sentiment to the asset class, the country's high-grade real estate market is, however, under strain from global economic shifts.

By **Christopher Chu**
February 12, 2020

In any tropical archipelago, business often runs on "island time". For the Philippines, that consists of almost 8,000 islands, economic developments sometimes run painfully slow.

President Rodrigo Duterte's ambitious 'Build Build Build' programme, a $180 billion infrastructure campaign to drive investment and economic growth while simultaneously removing bureaucratic red tape, is facing increasing pressure to deliver results.

For the 100 million Filipinos, the frustration of sitting in congested traffic jams on unpaved roads is a shared struggle. When the previous Aquino administration outlined its infrastructure initiative under a public-private-partnership (PPP), high expectations were met with slow delivery. Many Philippine corporations slighted the PPP as standing for nothing more than 'power point presentations.'

AYALA’S MAKE FIRST MOVE

Enacted in 2009, the Philippine Real Estate Investment Trust (REIT) law drew little interest as property developers were unhappy high public ownership requirements and transaction taxes to transfer their assets. But following more than a decade and several revisions later – the most recent, lowering public float requirements and adding in tax benefits, were made last month in January – appear to be sufficiently revised, attracting Ayala Land’s REIT (AREIT) to serve in the maiden voyage to test Philippine demand this year.

Ayala Land announced its interests to form a REIT, which is a company that manages and collects property rents and then distributes dividends to shareholders, in recent years. It only filed its application for the offering to the Securities and Exchange Commission in February.

Attracting Ayala Land, the property developer for Ayala Corporation, a conglomerate that includes Bank of the Philippine Islands, Manila Water, and Globe Telecom, represents a significant stamp of approval for both the regulator and exchange.

A successful and well received AREIT listing would set into motion other property developers to seek capital later this year according to Romel Libo-on, analyst at Maybank ATR Kim Eng Securities. “We expect other developers with sizeable rental assets such as SM Prime Holdings, Robinson Land Corporation, and Mega World Corporation to pursue [REITS] in the future.”

For example, DoubleDragon properties, the parent company of CityMall, is already examining the opportunity and hoping to raise $1.3 billion. A spokesperson said it was “looking at listing about a quarter of its currently completed leasable gross floor area (GFA) portfolio.”

NOT WITHOUT RISK

The AREIT portfolio will initially consists of three Grade A office buildings located near the central business district of Manila. “Ayala Land offices command better brand leadership, with occupancy rates higher at 95% and longer lease durations, typically between five to ten years,” Libo-on told *FinanceAsia*.

With Philippine 10-year government bond yields trading near 4.5%, an AREIT yield above 5% should be an attractive proposition particularly for insurance and wealth managers pursuing safer asset class investments. But the office space is not without its own sector risks.

Business processing outsourcing (BPO) units are witnessing many non-essential roles becoming automated while offices are increasingly choosing to move outside expensive city districts, putting the onus onto non-BPO companies to take up demand.

Philippine offshore gaming operators (POGOs), particularly those run by Chinese firms, account for about a tenth of the available office in Metro Manila and responsible for 37% of closed deals for the first nine months of 2019, according to Colliers International. Novel coronavirus and anti-Chinese sentiment are likely to challenge the outlook.

ATTRACTIVE NOW, BUT FOR HOW LONG?

“REITs typically benefit in a low interest rate environment”, according to Neil Mascarenhas, a portfolio manager at Hamon Investment Group, as investors look for assets that provide dividend income. Bangko Sentral ng Pilipinas, the Philippine Central Bank, has been cutting interests as inflation and energy prices remain benign.

However, should interest rate cycle suddenly reverse and borrowing cost rise, REITs will come under pressure as traditional lower-risk assets like government bonds become more attractive. This also comes in the back as other conventional steady assets like utility companies experience market erosion in the Philippines due to ongoing discussion with the government to craft new concession agreements.

Ayala’s Manila Water, along with Maynilad Water Services, the company led by tycoon Manuel V. Pangilinan, have been in the current administration’s cross hairs for not providing concessions viewed as being in the public’s interests.

SINGAPORE REIT DESTINATION UNCHALLENGED

Though the Philippine REIT developments are positive for domestic funds, replicating a Malaysia or India REIT market, rather than an international REIT market like Singapore is the most likely outcome.

Singapore’s legal and financial framework is a major draw for overseas funds, evident by the recent IPO of ELITE Commercial, which houses UK assets. ELITE unit holders could receive dividends in either Singapore dollar or equivalent in pound sterling, representing one of the six foreign currency denominated REITS in the city state.

Earlier this year CapitaLand Mall Trust announced its intension to merge with CapitaLand Commercial Trust in a $6 billion deal. The merger would be at least the fifth major tie-up in the Singapore REIT space over the past year, as trusts are looking to combine balance sheets to better compete for assets.

In Singapore, higher trading liquidity and lower capital costs potentially service as rerating catalysts for property developers, where 35 Singapore trusts have a combined market cap value of more than $100 billion. Based on cap rates and the potential assets for divestment, the Philippine REIT market is valued between $8 billion to $9 billion, according to Colliers International.

Ayala Corporation, one of the oldest and largest conglomerates in the Philippines, did not respond for comment for this story.