APREA

THE IMPACT OF REITs ON ASIAN ECONOMIES

APRIL 2014

KEN ATCHISON
& VICTOR S YEUNG

ABOUT THE AUTHORS

KEN ATCHISON

Managing Director, Atchison Consultants

Ken Atchison has been involved in financial markets since the early 1970s. After gaining significant experience in the management of investment portfolios, he moved to providing investment advice to superannuation funds. In the years prior to establishing Atchison Consultants in 2001, he was a senior asset consultant with the global firm Towers Perrin (now part of the Russell Group).

Mr Atchison's consultancy experience covers a broad range of areas within investment portfolio and business management. This includes advice on the setting up of investment management businesses, the choice of in-house or outsourced investment management arrangements, the setting of investment policy and structures for investment strategy, capital market analysis and investment manager research and selection. Mr Atchison holds a Bachelor of Commerce from Melbourne University.

VICTOR S YEUNG CFA

CIO, Admiral Investment Limited

Victor Yeung is the Chief Investment Officer of Admiral Investment Limited, where he oversees all investment programs of the firm. Before Admiral, Mr Yeung was Managing Director, Asia Pacific Securities of LaSalle Investment Management, where he managed the Asia Pacific portion of LaSalle's Global Real Estate Securities program and its Asia Pacific analyst team. Mr Yeung is the founder of Admiral Investment and commenced LaSalle's Asia Pacific Securities operations. He was a research analyst with Morgan Stanley and a risk underwriter with American Express.

Mr Yeung received the following degrees from the Massachusetts Institute of Technology:

- Bachelor of Science Degree in Electrical Engineering and Computer Science
- Bachelor of Science Degree in Management
- Bachelor of Science Degree in Political Science
- Master of Science Degree in Political Science

Mr Yeung is a Chartered Financial Analyst and holds the Advanced Diploma in Management Accounting with the Chartered Institute of Management Accountants. Mr Yeung lectures for the Asia Pacific Real Estate Association and the Hong Kong Securities Institute. He is the author of *Admiral's Field Notes: REITs and Rental Real Estate* and *Transforming Real Estate: A CMBS Primer*.

Published by
Asia Pacific
Real Estate
Association Limited
(APREA)
www.aprea.asia

n/n

Edited by
New Narrative Ltd.

CONTENTS

ABOUT THIS REPORT

Real estate investment trusts (REITs) are a relatively young asset class in Asia. The earliest markets to embrace the asset class were Japan and Singapore, both of which saw their first REIT initial public offerings (IPOs) just a little over a decade ago. Since then, REIT markets have emerged in Hong Kong, Malaysia, Thailand, Taiwan, and South Korea, with additional markets such as India and the Philippines introducing REIT legislation or considering doing so.

Given the youth of the Asian REIT market, it comes as no surprise that the asset class is not yet fully understood by the wider public in Asia. It is not often understood that REITs are in fact financial instruments (and relatively new at that) that broaden and deepen the capital markets, and that they have characteristics that distinguish them from equities and bonds. Sections of the media and the investment community have confused them for traditional corporate equities, have tended to view them as growth stocks and do not necessarily appreciate the differences between REITs and property stocks.

Because of the special regulations that have been developed for REITs in Asia and other general regulations that apply to trusts and listed securities, REITs have brought benefits to the way in which the real estate market operates, and by their nature have brought other benefits of a broader social and economic nature. These benefits have been recognised in non-Asian jurisdictions for some years (notably, in the US and Australia) but are not yet commonly understood in Asia. This is partly because no formal study has been undertaken anywhere which identifies and analyses these benefits.

APREA has been in regular dialogue with a number of regulators on enhancements to existing REIT frameworks, and with regulators in emerging markets that have yet to embrace this asset class. In some of these jurisdictions the case for REITs, and the benefits that they can deliver to an economy, are not well understood. This lack of understanding as to what REITs are and their potential benefits can act as an impediment to government support of the development of REIT markets.

An intellectually robust study into the impact that REITs can have on economies is necessary to:

- Develop a better general understanding in Asia of REITs as an asset class
- Explain the economic and social value that REITs can bring to the economy
- Encourage adoption of the REIT framework

APREA has commissioned this report to address these concerns.

The project has been developed and guided by a committee of members representing fund managers, investors and advisors. In addition, it has been underpinned by an extensive survey of real estate professionals across the globe – fund managers, investors and advisors from both the public and private markets. Our thanks to the committee for steering this very important project and to all of those industry professionals who participated in the survey, without whose assistance this project would not have been successful.

How REITs impact Asian economies
– entering the second decade

INTRODUCTION

Since their introduction in Asia in the early 2000s, real estate investment trusts (REITs) have been adopted across the continent, growing into a market worth over US$140 billion.

In terms of market capitalisation, the most developed markets are currently Japan, Singapore, and Hong Kong, but REITs have also listed on the stock exchanges of South Korea, Malaysia, Thailand and Taiwan.

Legislation varies across Asia, resulting in diverse development of REIT markets. Consequently, policy makers are now increasingly interested in adopting best practice legislation to further develop the asset class in countries that already have an active market, and to ensure a smooth start and healthy development for new REIT markets.

The objective of this report is to present a perspective on the impact REITs have on Asian economies. It includes how REITs have become a valuable option for long-term institutional and individual investors, how they have contributed to capital market diversity and development, and how they have become a positive force in the healthy development of property markets.

This report draws on an extensive survey by APREA of property market executives globally, as well as other independent studies on the impact of REITs on economies.

EXECUTIVE SUMMARY

The introduction of real estate investment trusts (REITs) to Asia offers institutional and individual investors liquid exposure to income-generating real estate. Real estate has investment characteristics that are distinct from that of the traditional asset classes - being equities and bonds - and so offers diversification benefits in a mixed portfolio. This means REITs are an investment that can help investors achieve better return/volatility outcomes. Pension funds and insurance companies have long valued real estate investment for its steady income and potential for capital gain. REITs allow both institutional and individual investors to access this investment sector in a more manageable quantity and with the benefit of better liquidity.

Introduction of REITs attracts capital, including foreign capital, into the property sector by creating a new and attractive vehicle for institutional and individual investors to invest in commercial real estate. REITs enjoy a relatively low cost of capital because of several factors, including liquidity, mandated dividends, tax concessions and a lower perceived risk profile due to limits on borrowing and on development risk. By selling stabilised assets to REITs, property developers can unlock capital that can be more effectively deployed in new development projects. Beyond the capital markets activity, this generates real economic output and creates new jobs in high-value areas such as asset management, investment appraisal, REIT management, legal and trustee services, investment banking, development management and construction.

Being dedicated landlords, REITs are often associated with improving the quality of real estate assets via refurbishments, asset repositioning and other enhancements. This translates to a better environment for tenants and for the community at large. Over the medium term, this feeds through into deeper professional expertise among asset managers and related professions.

REITs also support the healthy development of the property industry by improving market transparency. As listed vehicles, they are required to provide detailed information to shareholders about rental and capital values as well as occupancy rates and tenant mix, thereby improving the capacity of all industry participants to plan responsibly and helping to smooth out property cycles.

For the reasons outlined above, many Asian countries are looking to introduce REIT legislation or enhance existing REIT regimes. Although some governments fear a loss of tax income, studies have shown that REITs actually result in higher tax revenues. The resultant increased economic activity and job creation far outweigh any impact of tax concessions. Asian REIT markets are expected to continue their trajectory of healthy growth, with Singapore, Hong Kong and Japan seen as the most conducive markets for investors.

REITs – IMPROVING THE REAL ESTATE INVESTMENT LANDSCAPE IN ASIA

Chapter summary:

The introduction of REITs to Asia offers institutional and individual investors liquid exposure to income-generating real estate. Real estate has investment characteristics that are distinct from other major asset classes, being equities and bonds, and so offer diversification benefits to a multi-asset class portfolio. This means REITs are an investment that can help investors achieve better return/volatility outcomes. Pension funds and insurance companies have long valued real estate for its steady income and potential for capital gain. REITs allow both institutional and individual investors to access this important investment sector in a manageable quantity and with the benefit of better liquidity.

1.

INTRODUCTION TO REITs

The US House of Representatives describes the primary motivation for introducing real estate investment trusts (REITs) as “to provide all investors with the same opportunity to invest in large-scale commercial real estate that previously was open only to large financial institutions and wealthy individuals through direct investment in such real estate”.

A REIT is a collective investment vehicle that invests in a diversified pool of professionally managed, investment-grade real estate. The assets are typically office, residential, retail, hospitality and industrial or logistics property. In theory, any income-generating property may be included. Some REITs specialise in one asset type, while others offer a mixed portfolio. Real estate should provide investors with steady income generated from rent under lease contracts and potentially capital growth.

REIT markets first emerged in the 1960s in the US, followed by Australia in the early 1970s. From the late 1990s, and particularly the early 2000s, Asian governments have been passing legislation which allows the establishment of REITs, giving tax concessions which replicate the taxation treatment of REITs globally, including in particular the US and Australia. This reflects a better understanding of the benefits REITs offer both as an investment class and in improving the built environment and promoting economic growth.

Authorities are increasingly aware that healthy REIT markets often invigorate property markets by enabling developers to unlock capital in stabilised assets for reinvestment into productive new development projects. REITs also improve property market transparency by increasing information flows because their status as listed entities obliges them to disclose detailed information on the performance of their properties.

In its simplest form, a REIT provides ownership of a portfolio of properties in units that are held by investors as a way of securitising property. Most of the income from the properties, typically 90-95%, will be paid directly to investors as a dividend on a regular basis.

Conditional on the high dividend payout, most countries waive corporate income tax on the trusts. Investors therefore pay tax once, on dividends at their personal rate, rather than incur double taxation at both the REIT level, and the personal level. As a consequence, more of the revenue from the property assets flows through to investors than would be the case for traditional listed property companies.

A description of the categories and types of REITs in the market place is provided in Appendix B. Restrictions on operations, organisation and ownership of REITs in various countries are set out in Appendix A. The structure of an externally managed REIT is set out in Chart 1, and Chart 2 shows the growth of global REIT markets.

***Chart 1** – Typical structure of an externally managed REIT*

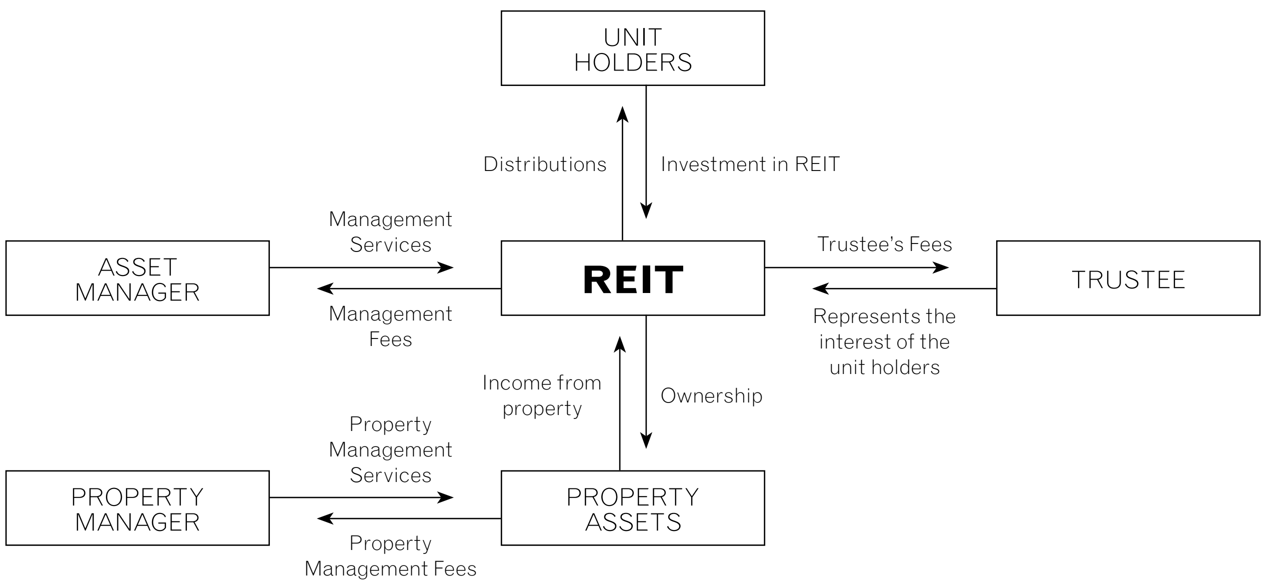
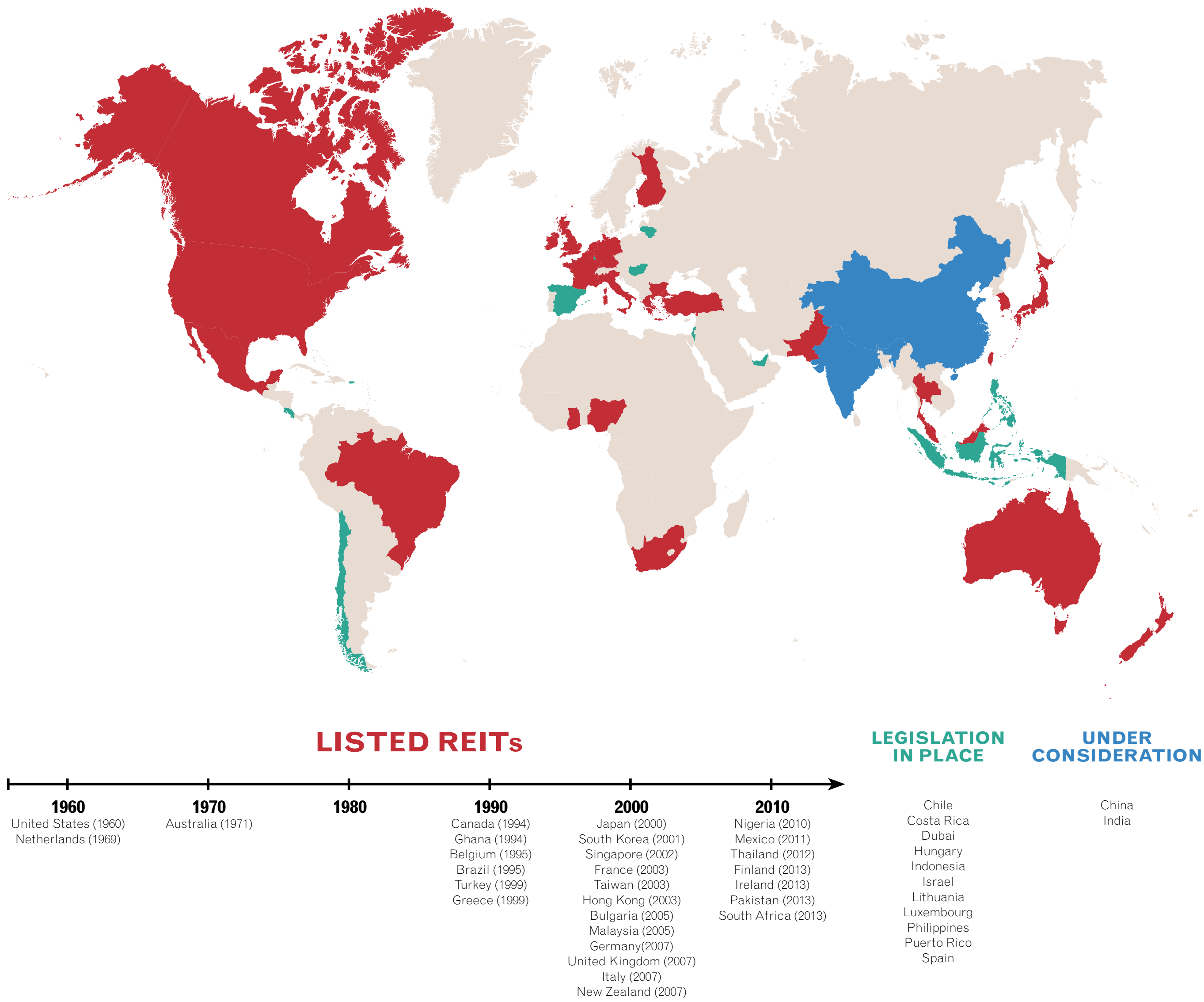


***Chart 2** – Growth of global REIT markets*



As at November 2013. Source: UBS estimates

REITs EMERGE AS A STABLE INVESTMENT CLASS

REITs are generally regarded as providing investment characteristics that lie between stocks and bonds.

Similarly to bonds, REITs offer a relatively secure and steady income, in the form of dividends derived from rental income. This income is usually quoted as a yield, being a percentage of the market price of the trust's units. Just like bonds, if the unit price moves higher in market trades and the dividend holds steady, the yield falls.

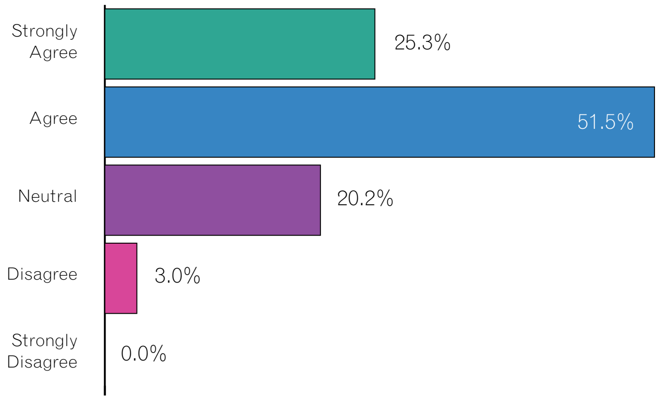
Unlike most bonds, the income from REITs is not fixed, but rather may fluctuate with changes in the income generated from leases. Rents can rise through terms of lease contracts or in times of healthy economic growth, due to enhancements made at the respective property, or when property demand outstrips supply. They may fall through increased vacancies. This more equity-like attribute explains why REITs typically trade at higher yields than government bonds.

As at the end of December 2013, Asian REITs were producing yield premiums above government bonds, with dividend yields ranging between 2.0% and 6.1%, while risk-free rates, as represented by 10-year government bond yields, ranged between 0.7% and 4.6%.

Because of multi-year rental contracts, REITs offer relatively stable income streams to investors. Based on estimates by Yeung (2013), even during the depths of the global financial crisis, rental income of REITs globally only fell by about 10% between the end of 2007 and the middle of 2009.

REITs are also believed to provide higher cash dividend payouts than other forms of real estate, as shown by respondents to the APREA (2013) survey.

***Chart 3** – REITs dividend payouts are perceived to be higher than other forms of real estate*



Source: APREA 2013

A key objective for REIT managers is to grow portfolio income and dividends for investors. To achieve this goal, managers may employ a more efficient use of space or renovate buildings to attract tenants willing to pay higher rents. Alternatively, they may raise equity or debt capital in order to acquire buildings that are earning a higher yield than the current yield of the existing portfolio, which is referred to as a yield accretive acquisition.

In some countries, REITs are permitted to develop property, which can provide attractive returns. But often, their capacity to develop may be restricted by market regulators. This lack of development risk, as well as the corporate tax concession, can be the main differentiators to investing in a listed property company.

INVESTMENT CHARACTERISTICS

As an investable asset class, REITs have desirable investment characteristics. They offer liquid exposure to commercial real estate. Because of their relatively low correlation of returns to the returns from equities and bonds, their inclusion in a mixed-asset class portfolio provides diversification benefits and helps investors achieve better volatility/return outcomes. Until the introduction of REITs, investors looking for liquid exposure to Asian real estate were largely limited to property developers which expose investors to development risks. REITs now offer exposure to steady and predictable rental streams.

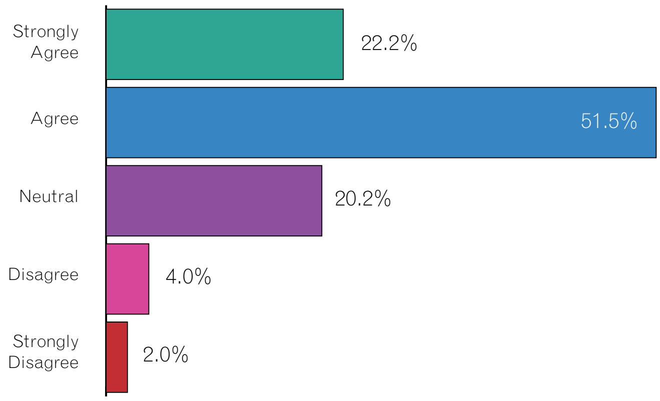
LIQUIDITY

REITs have essentially changed the nature of property investment, giving individual investors pure and easy access to high-value property, which was a domain previously reserved for large institutional investors.

For institutional investors, REITs offer liquidity and greater geographical and sectoral diversification. Because REITs are listed and their units easily traded, investors can easily take positions in investment property with substantially lower transaction costs than direct investment.

Survey results from the APREA (2013) study show that there is a general consensus amongst approximately 74% of surveyed investment professionals, that REITs offer better liquidity characteristics than other forms of real estate investments. Refer to Chart 4.

***Chart 4** – Better liquidity vs. other forms of real estate investment*



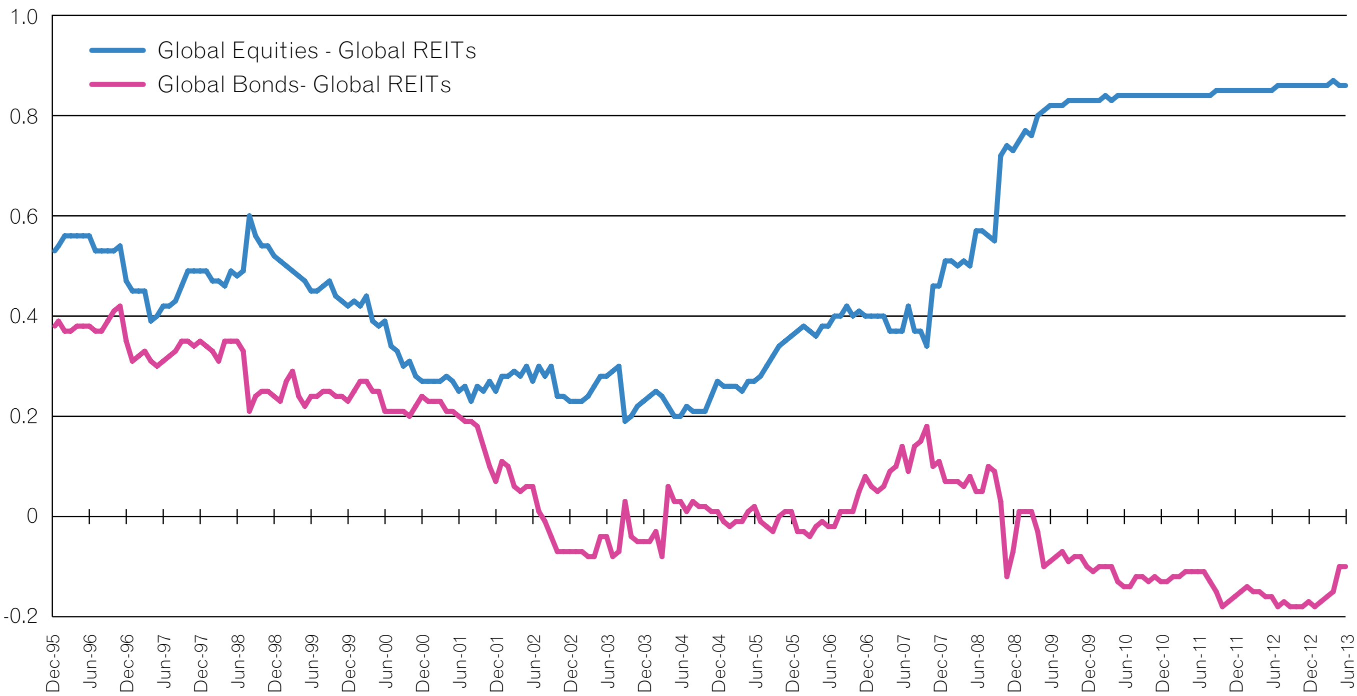
Source: APREA 2013

DIVERSIFICATION

Historically, returns from REITs have been lowly or negatively correlated with returns from bonds and moderately correlated with returns from equities. However, since the 2008-2009 global financial crisis, correlation with equities has increased, reflecting significant concurrent forces in listed shares and property prices. Firstly, when credit froze and later, during the subsequent recovery, as quantitative easing was introduced.

Chart 5 illustrates historical correlation of returns from global REITs to returns from global bonds and global equities. Correlations of returns are computed using the monthly returns over rolling 5-year periods.

***Chart 5** – Correlation of returns*



Source: S&P/Citigroup, MSCI, Atchison Consultants

Correlation of returns between REITs and other asset classes is also low in various Asia Pacific countries. Yeung (2013) tested the correlation between country-level UBS Investors Indices against their respective MSCI country share indices, and concluded that correlation is consistently in the moderate range from 2001 (index inception) to 2013.

*Table 1 – Correlation of country general and country real estate index**

	UBS Investor Hong Kong	UBS Investor Singapore	UBS Investor Japan	UBS Investor Australia
MSCI Hong Kong	0.5315			
MSCI Singapore		0.6644		
MSCI Japan			0.5588	
MSCI Australia				0.4435

** From 2001 or index inception to end of 2013*
Source: Bloomberg, Admiral Investment Limited

Because REITs will not necessarily move in tandem with other investments, investors can use them to reduce volatility of portfolio returns. According to consultants Ibbotson Associates, studies for US-focused portfolios showed that adding an allocation to REITs increased total portfolio returns and lowered portfolio volatility of returns.

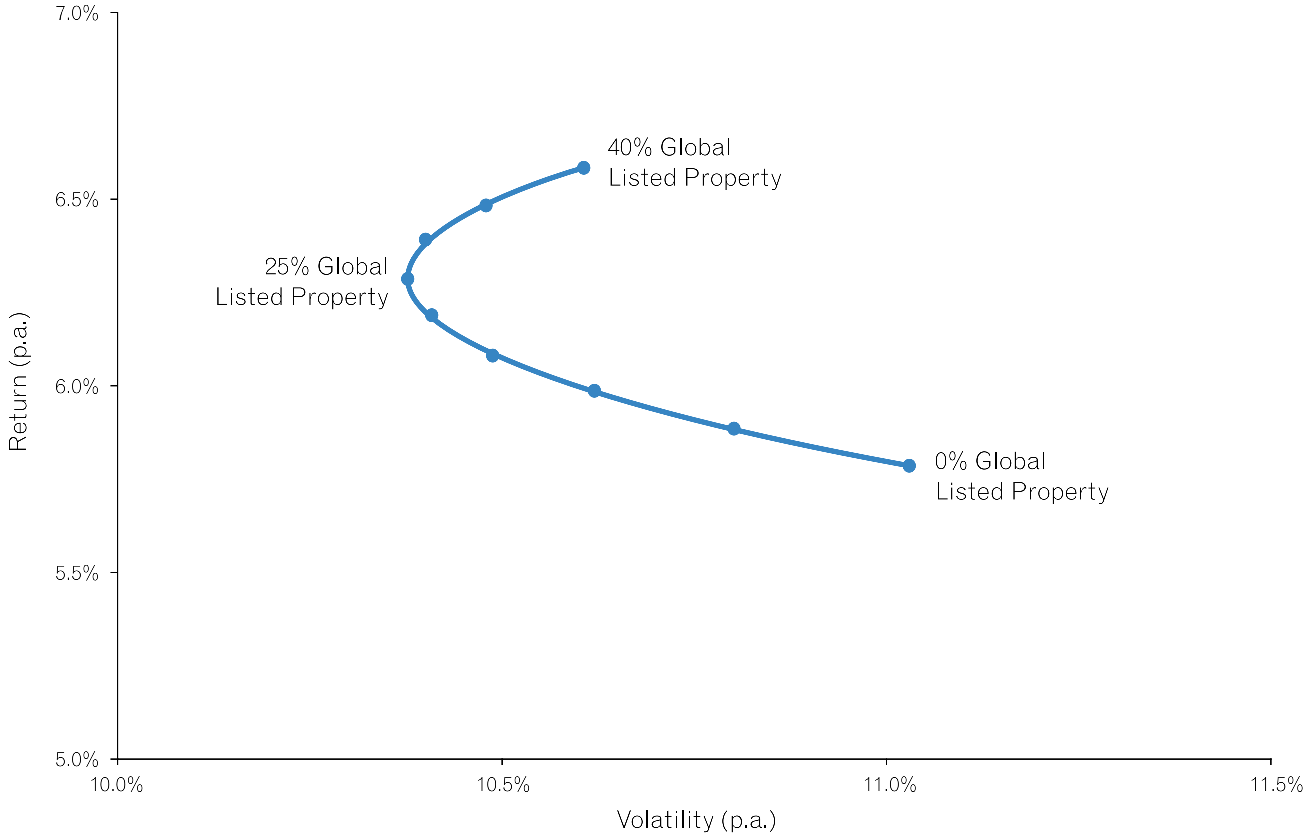
A portfolio containing a minor allocation to REITs would have produced higher returns and lower volatility of returns than a portfolio of only long-term bonds, stocks and treasury bills over much of the lifespan of the US REIT market.

Ibbotson Associates analysis showed that $10,000 invested in the non-REIT portfolio in 1972 with dividends reinvested would have grown to $219,049 by 2000. A second portfolio with a 10% REIT allocation would have reached $227,000, while a third that contained a 20% REIT allocation would have a value of $238,349.

Analysis undertaken by Atchison Consultants on the effect of adding exposure to global listed property[1] within a 70% growth portfolio of global equities and global fixed income found similar results as the study by Ibbotson. Chart 6 illustrates the findings.

1. S&P Citigroup World BMI REIT index – the index excludes property developers

Chart 6 – Inclusion of global listed property in a 70% growth portfolio



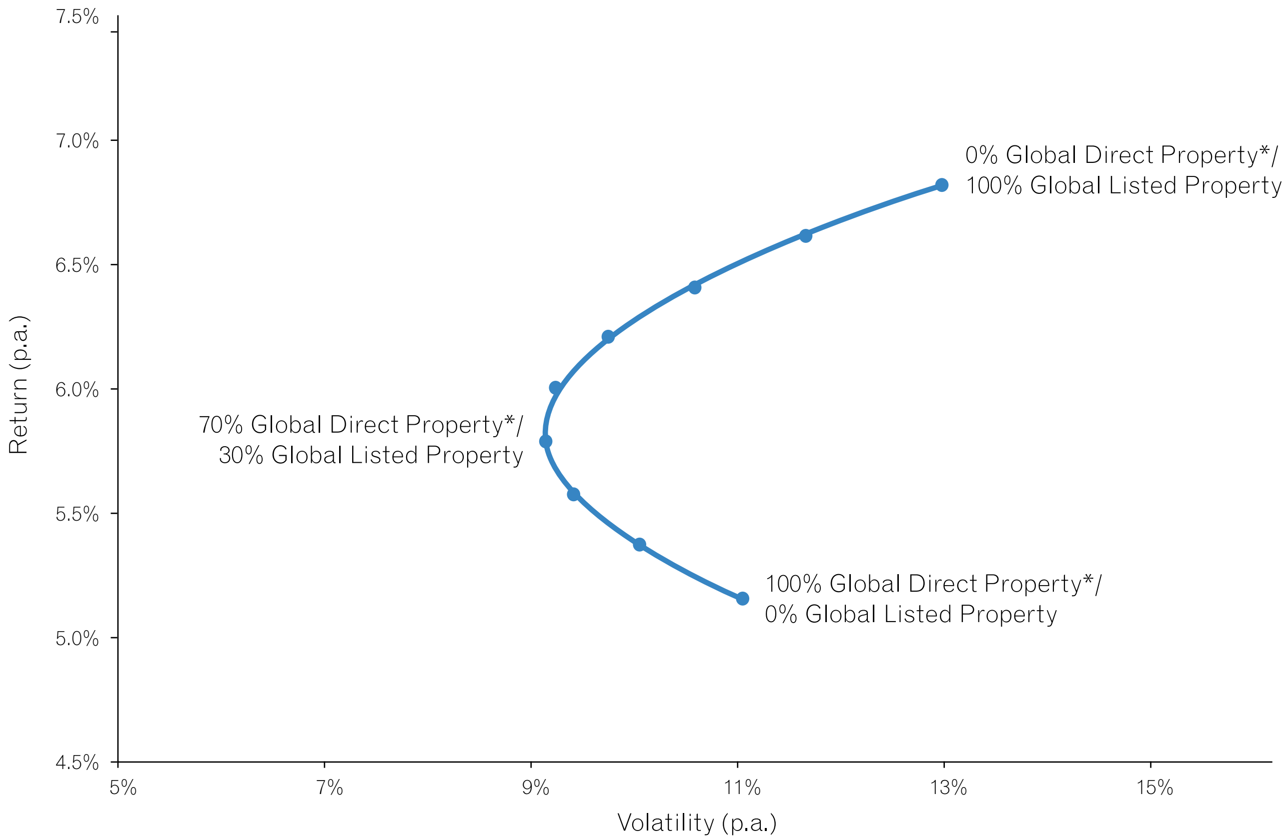
Source: Atchison Consultants, S&P/Citigroup (2013)

Drawing on historical performance for 25 years to June 2013, a 25% allocation to global listed property provided the highest return with the lowest level of volatility of returns for the growth portfolio.

These results are consistent with the findings of a 2011 study by the National Association of Real Estate Investment Trusts (NAREIT), a trade association representing the US REIT industry. The study found that a real estate portfolio with a meaningful allocation to REITs provided lower volatility of returns along with similar or higher expected net returns to a portfolio of real estate investments. In an open letter to California Public Employees' Retirement System (CalPERS) (2011), NAREIT explained that because of the lead-lag relationship and the difference in beta, from 1988 to 2010 a blended portfolio of direct (private) real estate and listed REITs generated a double-digit annual return 60% of the time, without a single year of negative return.

Analysis undertaken by Atchison Consultants on the effect of adding exposure to global listed property within a global property portfolio found a similar conclusion to the NAREIT 2011 study. The results are shown in Chart 7.

Chart 7 – Inclusion of global listed property in a property portfolio



Source: Atchison Consultants, S&P/ Citigroup (2013)
**Atchison Consultants Global Appraised Property Index (See Appendix C)*

Drawing on historical performance for 25 years to December 2012, a 30% allocation to global listed property and 70% to global direct property provided the highest return with the lowest level of volatility of returns in a global property portfolio.

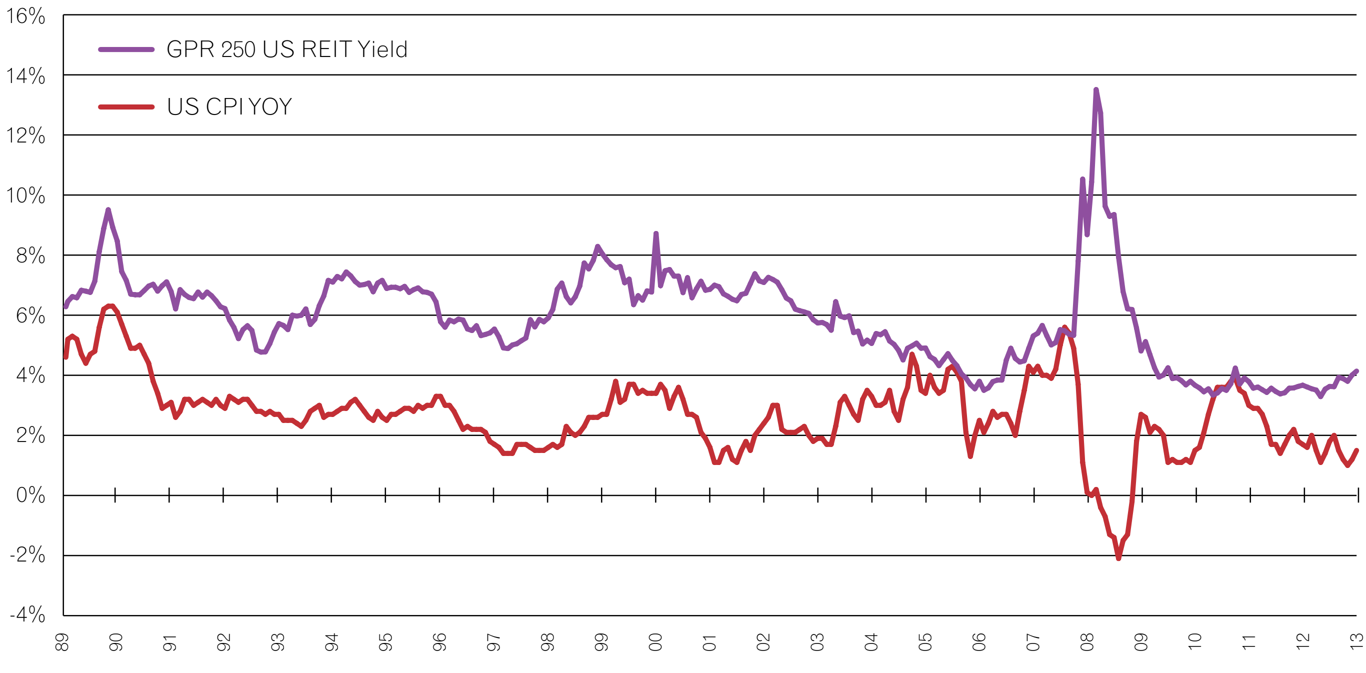
INFLATION HEDGE

A concern for investors in times of economic growth is whether price inflation in the wider economy will make REITs unattractive relative to other investments, or whether inflation might outpace growth in rental income, thereby reducing the value of dividends in real terms.

In the US market, investors are increasingly viewing REITs as a proxy for direct investment in property, which has inflation-hedging characteristics. For example, NAREIT has analysed the effects of a real estate portfolio with both direct and REIT exposures. Results from US REITs indicate that dividend growth typically outpaces inflation.

A comparison of the US REIT dividend yield and US inflation rate over 24 years to 2013 is provided in Chart 8. It can be observed that US REIT dividend yields are consistently higher than inflation rates over most periods. This supports the proposition of REITs as an inflation hedge.

***Chart 8** – US REITs dividend yield vs. inflation*



Source: GPR, Bloomberg, APREA

To explain this, consider that to the extent inflation is a function of stronger economic growth, occupier demand should be more robust and development should become more expensive, discouraging supply. Those factors, together with the ability to mark leases to market as rents increase and, in some cases, pass through increases in operating expenses to tenants, offer some degree of an inflation hedge to property owners.

REITs' attractiveness as an inflation hedge should also be considered in the context of alternative income-oriented investments such as bonds. While there may be some doubts as to how well REITs protect investors against unexpected increases in price inflation, bonds clearly expose investors to inflation risk due to their fixed cash flows and principal repayment. Higher discount rates result in lower net present values of bond and real estate cash flows. However, the impact on property values should be mitigated to some extent by higher replacement costs and rents.

Hence, while investors tend to mark down bond prices during inflationary and high-interest-rate periods because they demand a higher yield, there is often no need to downgrade the value of REITs. This trait was certainly appreciated by market participants in Asia in the early 2000s, as the region emerged from post-economic crisis deflation into a period of inflation, fuelled partly by government spending on infrastructure.

Findings from Lecomte P (2012) show that inflation rates and real estate returns in key Asian markets are correlated in the long run, indicating that Asian real estate assets can be used to hedge inflation over long periods of time (i.e. over 10 years). Rental indices (e.g. Beijing and Shanghai retail markets) exhibit co-integration with inflation rates in the long run, albeit with a lag, as opposed to capital value indices which tend to be more responsive. Short-run relationships between inflation and real estate returns were less obvious.

A GROWING INVESTOR BASE

One catalyst for growth in REIT markets across the world is coming from traditional large-scale investors such as pension funds and insurance companies that need steady returns to meet long-term liabilities.

On the basis of a body of research into portfolio modelling, the general consensus among pension fund managers now appears to be that 10-20% of their investment should be devoted to property.[2]

In many countries they are far below that threshold, partly because of the high concentration risk of investing millions of dollars into just a few illiquid buildings. In Japan, property accounted for less than 2% of pension fund investment in the mid-2000s. It was only 4% in France, nearly 5% in the UK and almost 6% in the US, according to a RREEF report. Pension funds in the Netherlands led the way with an average 10% property allocation.

Investing in physical property, in other words buying whole buildings, is attractive in terms of diversification because their returns have extremely low and in some cases negative correlation to returns of stocks. But REITs, despite a higher correlation of returns with stocks, are becoming more popular among pension funds and insurers because they provide global exposure and asset variety in a form that is more liquid and that comes in more manageable quantities.

This segment of demand for REITs is projected to experience significant growth. Most developed countries will see a dramatic rise in the number of retirees over the next 15 years, with the post-World War II baby boomer generation putting an especially large strain on pensions. For example, the proportion of the population over 65 in the US, Australia and Canada is forecast to rise to 30% by 2030 from 20% in 2011, according to the Organisation for Economic Co-operation and Development (OECD).

2. NAREIT (2011), "REITs, Private Equity Real Estate and the Blended Portfolio Advantage", Newell, G. (2011), "The Benefits of an Allocation to Asian Real Estate for Institutional Investors", APREA Research Project

In Asia, the United Nations (2001) estimates that the number of people over 65 will quadruple by 2050, when they will represent 18% of the total population, three times today's level. Japan will have roughly one retired person to every two of working age by 2025, a higher ratio than any other major industrialised nation. In China, where the population is aging rapidly due to policies intended to limit population growth, the burden on the working population, and the need to find suitable investments to fund pensions, will be even more acute. The population is aging because of policies designed to shrink the 1.3 billion population.

While institutional investors will remain key investors in REITs, individuals are investing as a solution to the increasing personal retirement burden, as governments and corporate pension plans shift to a defined contribution model from a defined benefit model. Traditional defined benefit plans, which pool the retirement savings of many plan participants, have long favoured real estate as an asset class for its stable cash flows, low volatility and low correlations with other asset classes. However, for individuals with defined contribution plans, REITs offer one of the few options for investing in commercial property as a source of stable cash yield.

Table 2 illustrates the United Nations' forecasts of changes in the share of population age 65 or above over the next 50 years across Asia, Europe, Australia and New Zealand, less developed countries and North America.

Table 2 – Forecast population 65+ (%)

	Asia (%)	Australia/New Zealand (%)	Europe (%)	Less developed regions (%)	Northern America (%)
1970	3.9	8.3	10.5	3.7	9.6
1980	4.5	9.6	12.4	4.1	11.1
1990	5.0	11.1	12.7	4.5	12.3
2000	5.8	12.3	14.7	5.1	12.4
2010	6.8	13.4	16.3	5.8	13.2
2020	8.8	16.4	18.9	7.3	16.7
2030	11.6	19.4	22.4	9.6	20.4
2040	14.9	21.2	25.0	12.1	21.5
2050	17.4	22.2	26.9	14	21.8
2060	20.6	23.5	27.8	16.2	22.7

Source: United Nations

CREATING MODERN, PROFESSIONAL PROPERTY MARKETS

Chapter summary:

REITs support the healthy development of the property industry. As listed vehicles, they are required to provide detailed information to shareholders about rental and capital values as well as their tenant mix, thereby increasing industry transparency. In turn, this improves the planning capacity of all industry participants, and may help to smooth property cycles. As dedicated landlords, REITs are improving asset management capabilities and enhancing professional standards in the real estate industry. By providing an attractive vehicle for institutional and individual investors, they have the potential to attract additional capital into real estate.

2.

IMPROVING ASSET MANAGEMENT

The increased competition and transparency that should arise with a dynamic, vibrant REIT market should lead to better maintenance and operation of assets. REIT managers can grow their portfolios through internal and external growth strategies. Internal growth strategies typically involve maximising the earnings and economic value of the existing portfolio through active asset management and enhancement programs, structured leasing strategies and the like. External growth strategies typically involve active portfolio management to maximise shareholder value through acquisitions, development and disposals.

REITs that are successful in their strategies, be it internal growth or external growth, will create shareholder value by growing their portfolios' net asset value, which should in turn be reflected in higher unit prices. This is because the value of a stock will take into account the expected value created by management strategies. For the best operators, the REIT will be rewarded with a lower cost of capital and more consistent access to equity and debt, providing a significant competitive advantage over peers.

Responses from the APREA (2013) survey showed most property industry executives believe that REITs have a competitive advantage versus other institutional participants in terms of asset management. They additionally reflect that REITs invest more in maintenance capital expenditure than other real estate investors. Maintenance capital expenditure includes both routine expenditure, such as changing light bulbs, to more substantial renovation that keeps an asset competitive over the long run. Renovation projects are harder to execute in a strata-titled[3] asset because of the difficulty in getting owners to unite for a major project. This is especially true when the renovation project has an overall beneficial impact but with an uneven distribution of perceived gains and/or costs. Because REITs are long-term investors and usually control properties through outright ownership (rather than strata-title), they have a strong incentive and are better positioned to invest and uphold the quality of an entire building.

The introduction of REITs also promotes professionalism across the real estate value chain. REIT managers require specialised professional knowledge over a broad area, including architecture, construction, asset and fund management, finance and law. Universities and industry organisations have responded with customised training programs and industry resources aimed at promoting best practices. APREA, for example, devised the Certificate of Real Estate Investment Finance (CREIF), a program to help provide the cross-disciplinary talent needed by the industry, training over 350 students in Singapore, Hong Kong, China, the Philippines, and Malaysia since its launch in 2008. Programs such as CREIF have fed the expansion of the REIT and private equity industry.

Increased professionalism in the real estate industry benefits society in many ways. Better knowledge in the investment and managerial process should encourage more effective decision making, which should provide more stability to the real estate market. REIT managers need expertise to analyse an asset's medium-term prospects, as the investment holding period is long term. Many of the managerial grade positions require professional knowledge.

A more developed professional REIT industry should make a significant contribution toward broadening and deepening real estate's investor base, including attracting institutional and private equity investors. This will contribute to the long-term development of the real estate ecosystem, which will further lift overall economic development.

3. Strata Title Schemes are composed of individual lots and common property. Lots are either apartments, garages or storerooms and each is shown on the title as being owned by a lot owner. Common property is defined as everything else on the parcel of land that is not comprised in a lot, such as common stairwells, driveways, roofs, gardens and so on.

JOB CREATION

The contributions of REITs to making the real estate industry more professional have a significant economic impact in terms of both job and GDP growth.

According to the Association For Real Estate Securitisation (ARES) (2012), the cumulative economic effect of Japanese REITs between 2001 to 2011 was estimated to be approximately ¥31 trillion, a 0.3% contribution to Japan's GDP growth. Over the same period, employment created was estimated at approximately 300,000 persons. ARES reported in 2012 that Japan employed 83,000 people directly with REITs.

Furthermore, ARES (2012) forecast that the contribution of the REIT sector to GDP will rise to 0.6% per annum by 2020 and its employment contribution will be an additional 128,000 jobs, if the REIT sector doubles in size this decade.

While REITs have grown as a new industry in itself, they have also promoted the growth of related professions. A PwC report (2012) showed that jobs are created throughout an asset's life cycle, from the construction phase (42% of work hours generated), major asset enhancement (29%), light refurbishment and improvements (25%) and during extension work (4%). REITs also need services from law, accounting, and real estate services. Increasing professionalism of REIT managers will encourage the service providers to evolve their services.

Studies in France also showed that REITs have created employment. PWC (2012) reported that SIICs (French REITs) created 66,300 jobs in 2011, representing an increase of 24.4% since 2003. By 2016, PwC (2012) expect that SIICs will generate an additional 140 million working hours in the construction/public works sector and 33,700 permanent retail jobs.

ADOPTION OF BEST PRACTICES

As a listed entity, a REIT must meet high standards of corporate governance, financial reporting and disclosure. As set out in REIT legislation in many countries and under governance by stock exchanges, disclosure requirements stipulate regular reporting to investors via audited financial statements, internal and external asset valuations, and portfolio strategies and operations disclosures.

According to the APREA (2013) survey, REIT corporate governance would be further improved through:

- Imposed restrictions on non-real estate activities
- Mandated dividend payouts
- Imposed limits on development activities
- Mandated limits on gearing levels
- External trustees

Respondents agreed or strongly agreed that restrictions on non-real estate activities (85%), mandated dividend payouts (80%), limits on gearing levels (77%), limits on development activities (65%), and oversight by external trustees (63%) are desired. Less than half of respondents agreed or strongly agreed that having an external manager or limits on geographic exposures improves corporate governance.

Industry practitioners believe that REITs are encouraging the adoption of best practices across the real estate sector.

A majority of respondents to the APREA (2013) survey believe that real estate definitions and metrics are becoming more consistent among REITs across markets. The adoption of similar practices, particularly valuation methodologies, amongst Asian REITs is bringing Asia Pacific markets closer, encouraging more cross-border investment and more efficient pricing of real estate.
It is also supporting the broader efforts encouraging standardisation of international property measurements that APREA and other associations are working on through the International Property Measurement Standards Coalition (IPMSC).

INCREASING TRANSPARENCY

A major benefit of the introduction of REITs is increased transparency through the disclosure requirements that stock exchanges set for the listing of REITs. Historically, commercial real estate has been a notoriously opaque asset class. Greater transparency helps to improve property market dynamics, giving industry participants better access to information to assist with planning, underwriting and monitoring their investments, and has an added benefit of attracting greater flows of international capital. In this way, the introduction of REITs can initiate a virtuous cycle.

The Jones Lang LaSalle (JLL) Transparency Index shows that countries with established REIT markets tend to rank higher for transparency, as gauged by various measures, including a consistent legal and regulatory framework, enforcement of rules, and respect for private property rights. In Asia and globally, higher ranked countries have listed REITs.

Table 3 outlines the ranking of the level of transparency across various Asian property markets.

***Table 3** – Level of transparency**

	Country	Level of transparency	Composite score	2012 Composite rank
Established REIT markets	Hong Kong	Transparent	1.76	11
	Singapore	Transparent	1.85	13
	Malaysia	Transparent	2.32	23
	Japan	Transparent	2.39	25
	Taiwan	Semi-transparent	2.60	29
	Thailand	Semi-transparent	2.94	39
	South Korea	Semi-transparent	2.96	41
REITs legislation in progress	Philippines	Semi-transparent	2.86	35
REITs adoption under consideration	China Tier 1	Semi-transparent	2.83	32
	India Tier 1	Semi-transparent	3.07	48

** Transparency scores rank from 1 (most transparent) to 5 (least transparent)*
Source: Jones Lang LaSalle Transparency Index 2012

The JLL Transparency Index is consistent with the feedback from the APREA (2013) survey. Over 70% of respondents agreed or strongly agreed that REITs are more transparent than other listed real estate vehicles, and over 85% of respondents agreed or strongly agreed that REITs have more transparent disclosure regimes than other unlisted alternatives. This is a major driver of the consistent improvement in real estate market transparency that the industry has observed.

The APREA (2013) survey showed that approximately 74% of investment professionals believe that existing REIT markets, on average, have more transparent disclosure regimes than other listed alternative asset classes, such as general equities.

Likewise, over 75% of respondents agreed that REITs have helped improve valuation methodology and disclosure standards over the years. International Financial Reporting Standards (IFRS) requirements of regular re-evaluation of real estate assets enforced a consistent framework in valuing real estate, which is released as public information through the announcement of financial results by REITs. In some markets, Japan in particular, details on rents, at the building level, are also available, which creates a data series that was unavailable before REITs became a major participant.

REAL ESTATE INNOVATION

The competitive pressures of the forward-looking public markets encourage REITs to continually search for new growth opportunities and to explore diverse asset types with stable, attractive yields. Some have therefore developed specialised niches such as modern logistics facilities, data centres, medical facilities and business parks, which often have been overlooked by traditional institutional investors.

Results from the APREA (2013) survey backed up the view that REITs help innovation by introducing professional property management to new areas. Approximately 65% of respondents believe that REITs function well as an investment vehicle in emerging real estate segments. While this activity provides investors access to attractive, untapped sectors within the commercial real estate investable universe, it also helps to support the development of an economy into new areas. For example, a high-quality IT industry needs high-grade business parks and data centres. A modern supply chain needs high-quality logistics assets which can reduce transition time and costs.

REITs are particularly suitable for the creation of critical mass in new areas of real estate because they have the expertise to tap international demand. For example, in Japan and China, REITs were initially the main providers of modern logistics property required by global companies. They were particularly adept in building and managing buildings with precise specifications, such as high ceilings, ease of access, and a large floor plate without columns which is necessary for operation of an automated supply chain. Over time, this has had the effect of gradually improving the stock of all types of real estate where REITs are active, which benefits users and the overall economy.

POSITIVE IMPACT ON PROPERTY CYCLES

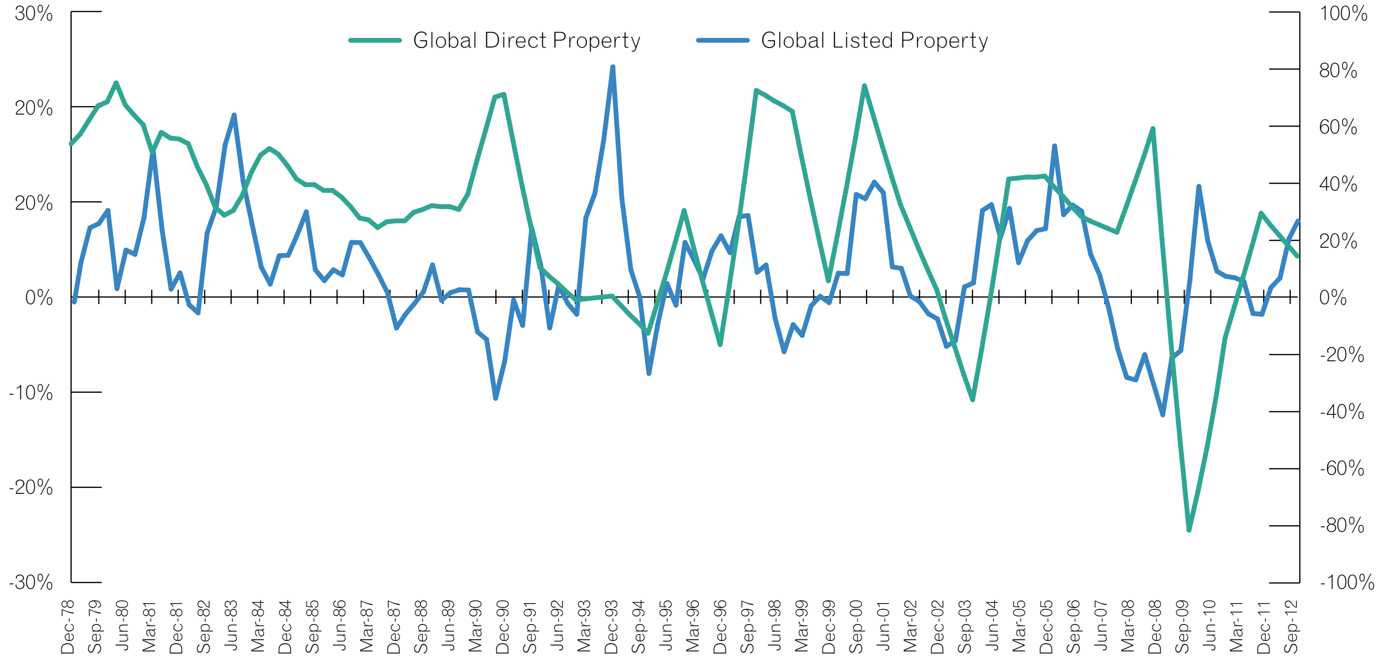
The introduction of REITs may help to dampen the boom-bust cycle for which real estate is known by encouraging greater equilibrium between supply and demand. By improving information flows, REITs allow participants to make better informed decisions about market fundamentals, capital pricing and, ultimately, risk and return.

The institutional design of REITs, including investment limits, dividend requirements, and disclosure requirements, reduces agency conflicts, according to Bauer, Eichholtz and Kok (2010). Yeung (2013) also discussed that the disclosure provided by REITs has helped create more transparent real estate markets, with Japan being the clearest example. The data generated by J-REITs, from operational metrics such as rents and occupancy, to investment ones such as cap rates and yield, have made the entire Japan real estate market more transparent. Furthermore, since many J-REITs report in English in addition to Japanese, the non-Japanese speaking international community also has access to more and better real estate data in Japan.

At a country level, according to Atchison Consultants (2013), the listed market generally leads the direct property market by six to 18 months, as listed property liquidity allows for greater pricing transparency and more immediate information transfer than direct markets, which are less liquid.

Analysis undertaken by Atchison Consultants (2013) shows the relationship between global listed property and global direct property. Chart 9 shows rolling annual returns of global listed property and global direct property over 34 years to December 2012.

***Chart 9** – Listed property leads direct property: rolling annual returns Dec 1978 – Dec 2012*



Source: S&P/Citigroup, Atchison Consultants (2013)

Findings from the analysis show that global listed property leads global direct property by up to 18 months.

While listed property provides leadership in terms of direction, it tends to overshoot direct property market movements due in part to investor sentiment in the broader equities market. Similarly, investor sentiment may cause pricing in the listed market to deviate from the direct market, creating arbitrage opportunities for long-term real estate investors to effectively buy assets at a discount to their underlying intrinsic value.

In theory, arbitrage should dampen the extremes in markets as listed vehicles will be restrained from raising new capital for acquisitions when property prices are excessive and prospective acquisitions are dilutive for distribution yields. Equally, privatisation of listed vehicles can occur when prices of listed property are excessively depressed. While markets do not always behave rationally, the existence of a vibrant listed REIT market provides an important mechanism that makes it possible for investors to capitalise on arbitrage opportunities.

Property markets are also positively affected by the fact that REITs are professional property managers. Given their shareholder mandate to maximise net property income and hence dividends, REITs are incentivised to maximise tenant occupation and optimise rents in relation to market levels. This stands in contrast to private investors who invest with a variety of motivations and may opt to avoid the demands of leasing out a unit should they be focused on capital gains. This is reflected in the APREA (2013) survey, where respondents agree that REITs have increased competitive pressure for tenants. The overall impact is that REITs can be seen to contribute to the efficiency of demand-supply and pricing dynamics, and hence to smoother property cycles.

Respondents to the APREA (2013) survey also supported the idea that REITs should take on some development activities in their area of expertise. This flexibility potentially allows for interesting strategies to grow the portfolio and allow investors to participate in value creation. Logistics REITs, for example, are known for their build-to-suit activities, where a logistics landlord would first secure a tenant before building an asset. This type of development also reduces demand uncertainty, promoting steady supply and more predictable rental trends, which should smooth real estate cycles and reduce uncertainty in an economy.

The existence of REITs may additionally reduce speculative construction activity. If property companies undertake development projects with a sale to a REIT as the anticipated exit, a project's viability becomes dependent on the underwriting standards of REITs, for example on leasing levels, and ultimately by the appetite and approval of a wide investor base. The result should be reduced volatility in rental and acquisition markets.

INVESTMENT IN REAL ESTATE AND THE WIDER ECONOMY

Chapter summary:

The introduction of REITs attracts extra capital including foreign capital into the property sector by creating a new and attractive vehicle for institutional and individual investors to invest in commercial and sometimes residential real estate. REITs enjoy a relatively low cost of equity capital because of several factors, including scale, liquidity, mandated dividends, and limits on borrowing and development risk. By selling stabilised assets to REITs, developers can unlock capital that can be more effectively deployed in new development projects.

3.

LOWER COST OF CAPITAL

REITs tend to enjoy a relatively low cost of equity capital because they are relatively low-risk and provide predictable income. In the APREA (2013) survey, respondents agreed that REITs enjoy a lower cost of equity capital compared with the commercial property division of developers. Increased transparency, limits on gearing levels, mandated dividend payments, limits on development activities, and external trustees are all cited as reasons for lower risk and lower cost of capital.

The increased disclosure requirements of listed REITs provide investors with improved visibility into cash flows, operating and balance sheet metrics and should, in turn, reduce uncertainty (risk). A study by Diamond and Verrecchia (1991) showed firms with a higher level of transparency reduce information asymmetry and consequently a firm's cost of capital. Beatty, Ramesh, and Weber (2002) concluded that the cost of debt is lower if loan agreements contain covenants that guarantee transparency.

Earnings yield can be used as an indication of the cost of equity capital. Table 4 provides an estimated earnings yield for REITs and property companies across various jurisdictions. Earnings yields and thus cost of capital are lower for REITs than property companies except in Japan and the US. In Japan and the US, the expectation is that profits of property companies will recover strongly in the medium term.

Table 4 – Earning yields estimate as at 31 December 2013

Markets	REITs*	Property companies**
Australia	7.1%	8.7%
Hong Kong	4.5%	7.7%
Japan	3.3%	2.2%
Singapore	5.8%	5.7%
Continental Europe	6.1%	6.1%
US	5.2%	3.6%
UK	2.1%	4.0%

Source: UBS, Atchison Consultants 2013
** REITs' dividend yields*
*** Property companies – Net income/market capitalisation*

As shown in Table 5, the earnings yield of REITs on a global level has generally been lower, on average, than that for developers and property companies.[4] The notable exception was during the boom years leading up to the global financial crisis, when risk appetite was high, credit and equity capital was readily available, and both developers and property companies traded at lower earnings yields.

Table 5 – Global earnings yield

	REITs	Developers	Property companies
Dec 06	5.3%	5.4%	4.8%
Dec 07	6.7%	4.2%	4.2%
Dec 08	10.3%	8.8%	8.4%
Dec 09	5.9%	5.7%	5.8%
Dec 10	5.5%	5.8%	5.7%
Dec 11	5.8%	9.6%	9.2%
Dec 12	5.1%	7.7%	7.2%
Dec 13	5.3%	9.4%	8.6%
Average	**6.2%**	**7.1%**	**6.7%**

Source: UBS, Atchison Consultants 2013

4. A REIT owns and operates income producing commercial and residential property assets or property related assets.
A property company owns property assets and undertakes property development for ownership.
A property developer undertakes development of commercial and residential property, more commonly for sale.

An analysis of Australian listed property developers and Australian REITs shows that on average REITs benefit from a lower cost of equity capital, on a pre-tax basis. Unlike REITs, property developers are taxable entities.

Table 6 – A-REITs vs. listed property developers cost of equity capital – 1991 - 2013

	REITs	Property developers
Pre-tax yield	9.5%	10.3%

Source: UBS, Atchison Consultants 2013

Similarly, an analysis of the difference in cost of equity capital between Australian unlisted property and A-REITs is shown in Table 7. Here, an adjustment is required for the fact that unlisted property is ungeared and A-REITs typically are geared at 35%. Adjusting for this factor the REIT cost of equity capital would be 7.25% - 7.5%, which is slightly below or on par with the cost of equity capital for unlisted property.

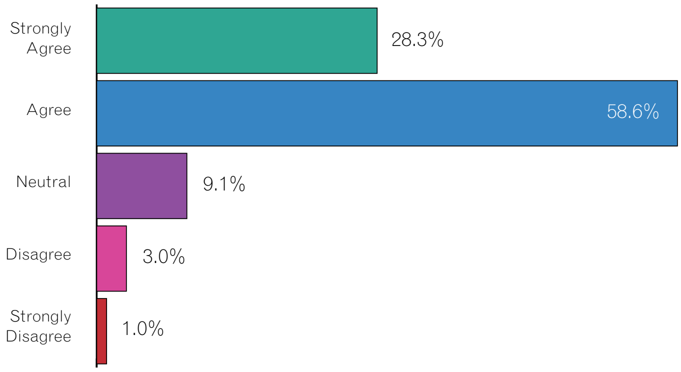
Table 7 – A-REITs vs. Australian unlisted property cost of equity capital – 1991 - 2013

	REITs	Unlisted property
Ungeared average yield	7.5%	7.6%

Source: UBS, Atchison Consultants 2013

Respondents in the APREA (2013) survey, as indicated in Chart 10, believe that a major explanation for access to lower cost of capital by REITs is the tax pass-through feature of REITs, which means that tax is only applied on earnings of REITs when received by the final investors. There is no double-taxation of income being borne by investors, thus lowering their expected gross returns on equity exposure in REITs. This should translate into a lower cost of equity capital.

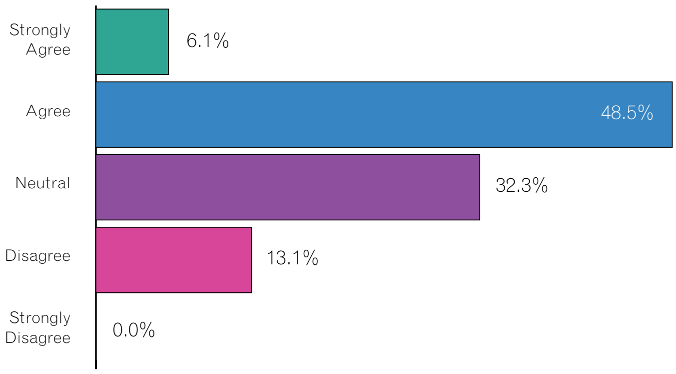
Chart 10 – REIT tax free status results in lower cost of capital



Source: APREA 2013

Results from the APREA (2013) survey, as presented in Chart 11, demonstrate strong agreement that REITs have the ability to raise and borrow funds for development projects at a lower cost of capital than property developers. To the extent that REITs can use a portion of their balance sheets to pursue development projects, REITs have access to cheaper debt funding and lower equity return expectations from unit holders, resulting in lower cost of capital.

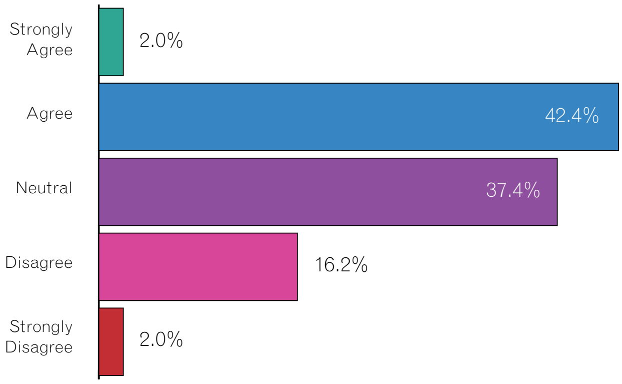
Chart 11 – REIT access to lower cost of capital for development projects



Source: APREA 2013

Charts 12 to 15 summarise the responses by investment professionals, from the APREA (2013) survey, regarding a selected list of characteristics that contribute, all else being equal, to REITs having access to a lower cost of capital. Respondents perceive that mandated dividend payouts would provide access to a lower cost of equity capital to REITs as shown in Chart 12.

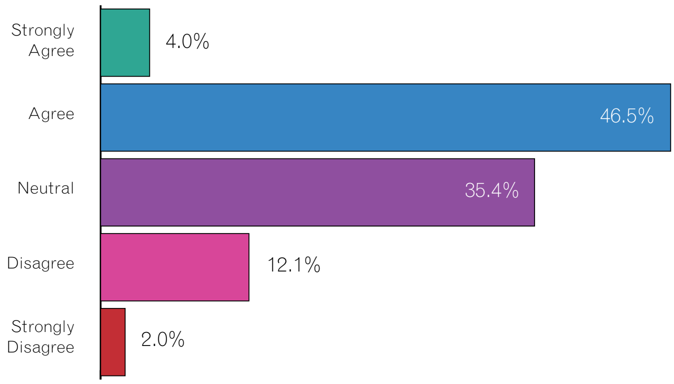
Chart 12 – Mandated distribution of dividend



Source: APREA 2013

Respondents believe that limitations or restrictions on REITs' ability to participate in development activities will lower their cost of capital as shown in Chart 13.

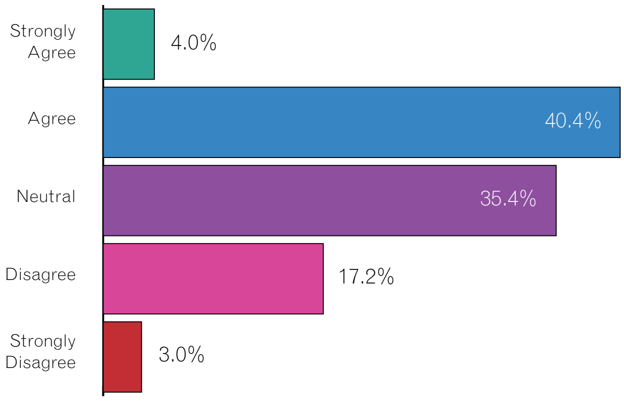
Chart 13 – Restriction on development activities



Source: APREA 2013

Respondents believe that specialisation in a single sector would also reduce a REIT's cost of capital relative to a REIT with a diversified set of properties as shown in Chart 14. However, a study by Ambrose and Linneman (2001) reported that single-sector REITs generally carry a higher cost of capital, when compared to diversified REITs. Office and hotel REITs incurred a higher cost of capital relative to diversified and healthcare REITs. Research by APREA (2013) showed that retail REITs generally have a lower cost of capital, when compared to diversified REITs. The mixed results from the studies may say more about the different characteristics of specific sectors than specialisation generally. However, one conclusion may be that investors will differentiate between property types, ascribing a lower cost of capital to sectors where specialisation can result in operating efficiencies and/or competitive advantages.

Chart 14 – Single sector focus



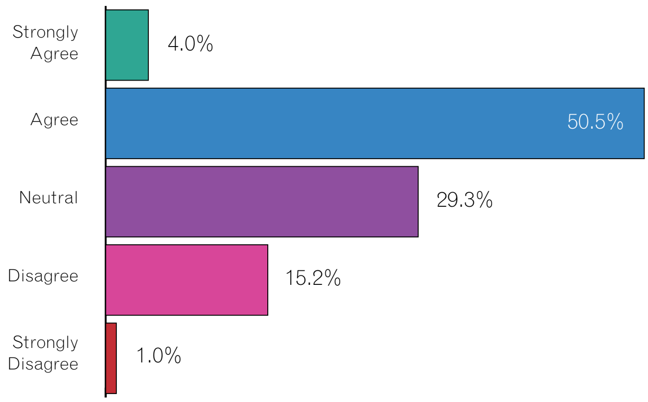
Source: APREA 2013

Chart 15 illustrates that respondents anticipate a lower cost of capital would result from imposed gearing limits on REITs.

Unlike some longer-established REIT markets, Asian REITs have a more conservative approach to gearing amidst strong regulatory restrictions. The aggregate lower level of debt held by Asian REITs has been a factor in the strong recovery and performance of those markets post the global financial crisis.

Aggregate gearing levels across Asian REIT markets are below 35% whereas aggregate US REITs gearing is around 55%, according to UBS (2013).

Chart 15 – Imposed gearing limits



Source: APREA 2013

RECYCLING CAPITAL ACROSS THE ECONOMY

A key benefit of a vibrant REIT market is the improved efficiency and more rational allocation of capital. With their focus on income-producing assets, REITs are better able to attract capital seeking property exposure, thereby freeing capital that can be better invested elsewhere to expand businesses and invest in new ventures.

Among the main beneficiaries are traditional property companies that use REITs to separate the roles of developers and landlords, and achieve a more efficient deployment of capital.

Property companies see REITs as natural buyers of completed assets. The ability to recycle capital for further property development and therefore increase the supply of investment grade properties brings further economic and job creation benefits.

This is particularly true with property types such as retail and hotel assets, where a critical mass of investment grade assets can become a tourist attraction, attracting spending from foreign travellers. For example, a majority of well-maintained malls along Orchard Road, Singapore, are now owned by REITs, freeing up developers to further develop other areas. This is also true for newer, more specialised sectors.

For example, CapitaLand, based in Singapore, has been successful in using the capital recycling model. With six affiliated listed REITs, each with a distinct geographic and sector focus, CapitaLand has sold most of its stabilised assets into REITs. This allows CapitaLand to recycle its capital into further projects and this continued expansion helps speed up urban development.

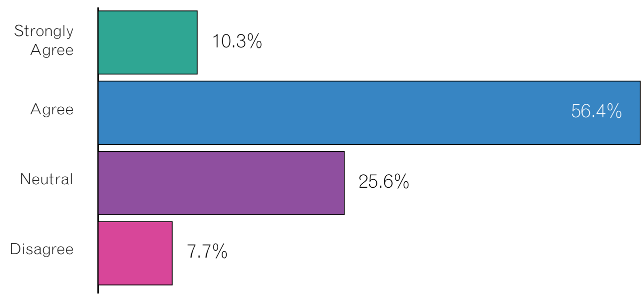
To better understand the impetus for developers to spin off assets into REITs, APREA interviewed a sample of REIT managers across Singapore, Hong Kong and Malaysia in 2013. A few common strategic drivers that were identified include:

- To enhance financial capacity and flexibility through capital recycling
- To allow different management teams to focus on different businesses such as property development
- To create stand-alone real estate-focused vehicles with income generating investment properties and better transparency so as to reduce holding company discount to net assets
- To lower cost of capital due to access to corporate level debt and equity which may support the company's long term growth and development

REIT structures in Asia have also given rise to an alternative source of finance which supplements the traditional bank financing. Much of Asia's commercial real estate is owned by operating companies, rather than dedicated landlords. Selling to a REIT, including through sale-leaseback transactions, becomes an attractive option to raise funds for growth, because of the relatively lower cost of capital involved. This is emerging as a strong trend as REITs look to expand, and should drive the rapid expansion of the Asian REIT market.

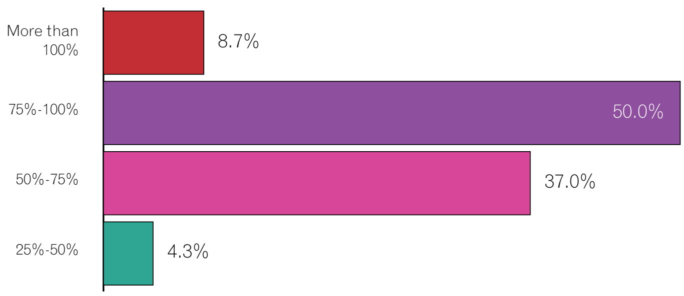
A lower cost of capital for companies acts as an incentive for increased investment. Charts 16 and 17 from the APREA (2013) survey indicate that over 70% of fund managers expect their REIT-only mandates will grow in the next 24 months. Further, about one-third expect assets under management for their REIT-only mandates to grow by more than 25%, with 10% expecting more than 50% growth.

Chart 16 – REIT-only mandates to grow over the next 24 months



Source: APREA 2013

Chart 17 – REIT-only mandates to grow by as a percentage of current AUM



Source: APREA 2013

CONTRIBUTOR TO CAPITAL MARKET DEVELOPMENT

The Asian financial crisis in the late 1990s highlighted the importance of having a developed capital market to supply long-term capital and complement a sound banking system. Before the crisis, many Asian economies were heavily reliant upon the inflow of short-term foreign capital, including through money markets, to finance long-term economic development needs. This produced an investment timeframe mismatch that caused economies to unravel following a capital flight from the region.

The close relationship between capital market development and economic growth has been studied intensively. For example, in a study of Romania, Barna and Mura (2010) showed that capital market development is positively correlated with economic growth, with feed-back effect in both directions. In a study of Malaysia, Manap et al. (2012) used Granger causality tests to demonstrate a significant causal relationship from financial development to economic growth.

Demirguc-Kunt and Levine (1996a, 1996b), from their study of 44 developing countries, reported that increased market capitalisation, liquidity and integration with global markets are key contributors to economic growth.

Capital markets help to reduce risk in the financial system by diversifying sources of capital. They help channel long-term savings into productive use, and help improve information flows and corporate governance standards. Bekaert and Harvey (2000), in a study on the impact of equity flows and behaviour of emerging market equity returns, showed that an increase in capital flows is associated with marginally higher per capita GDP, a larger trade sector, less long-term country debt, lower inflation, and lower foreign exchange volatility.

Many Asian capital markets have experienced a sizeable transformation over the last two decades, growing in size and moving from an opaque, relationship-based system into a public, transparent system. As a consequence, governments and businesses in Asia are benefiting, tapping capital markets as a source of long-term financing rather than depending on traditional bank lending.

The introduction of REITs in Asia has helped to broaden and deepen capital markets, offering a liquid real estate asset class to complement equities and bonds.

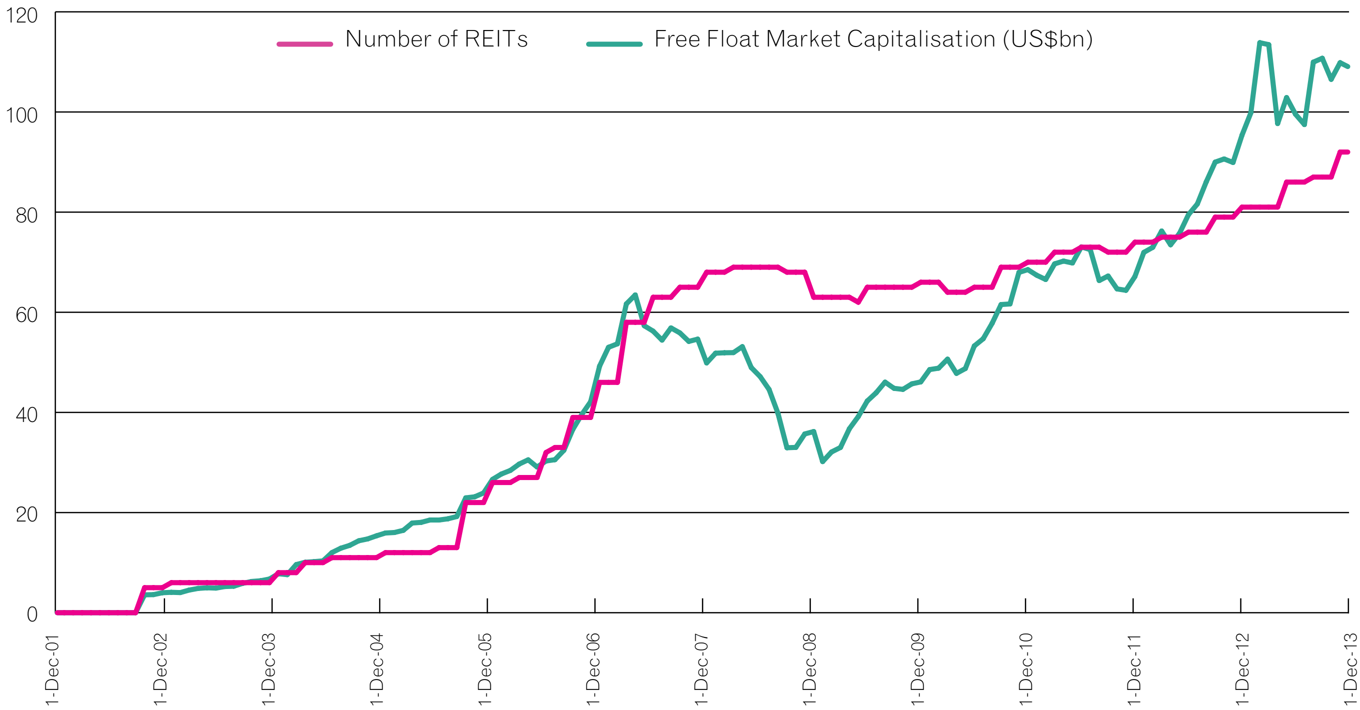
Because of their investment characteristics, REITs are particularly suitable for institutional investors, such as pension funds and insurance companies, and therefore help Asian countries to tap a pool of global long-term savings.

REITs help diversify sources of finance for real estate, reducing dependency on bank lending, and contribute to greater capital allocation efficiency. They provide integration between real estate and capital markets, which subsequently contribute to economic activity and growth. In a study of the US market, Ling and Naranjo (1999) concluded that there is a greater integration between REITs and equity capital markets than non-exchange traded real estate and equity capital markets.

As at 31 October 2013 global listed real estate was valued at over US$3 trillion, accounting for approximately 11.8% of total real estate assets, which was valued at US $25.7 trillion (UBS, 2013). In North America listed real estate constitutes 15.1% of total real estate assets. If global listed real estate increased to this level the market capitalisation would increase to US$3.9 trillion.

Chart 18, below, shows how REITs have contributed to the deepening of key Asian capital markets.

Chart 18 – Growth of Asian REIT markets



Source: GPR, APREA

Despite falls in market capitalisation during the global financial crisis, when all global equity markets fell, REIT markets in Japan, Singapore, Hong Kong, Malaysia and Taiwan have experienced a substantial increase in market capitalisation over seven years to 31 December 2013.

Table 8 – Market capitalisation of major Asian REIT markets ($USm)

	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013
Japan	41,197	28,398	27,835	45,167	37,810	50,193	71,199
Singapore	15,913	7,435	17,551	23,975	23,847	36,391	40,301
Hong Kong	8,614	5,951	9,591	12,376	12,432	17,554	17,189
Malaysia	1,276	971	1,283	3,073	3,765	6,474	6,808
Taiwan	1,531	1,350	1,635	1,882	2,045	2,636	2,759
Total	**68,530**	**44,104**	**57,895**	**86,473**	**79,899**	**113,247**	**138,255**

FURTHER ENCOURAGING REIT MARKETS

Chapter summary:

Many Asian countries are showing interest in introducing REIT legislation or enhancing existing REIT regimes. Although some governments fear a loss of tax income, studies have shown that REITs actually result in higher tax revenues. Their taxation regimes simply put REITs at 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.

4.

CREATING SUPPORTIVE LEGISLATION

Because of the positive impact REITs have had on the investment landscape, property industry, capital markets, and real economy, many Asian countries are showing interest in introducing REIT legislation or enhancing existing REIT regimes.

However, there are often various hurdles that need to be cleared before the establishment of a vibrant REIT sector in a new market. The critical issue is support from governments through the enactment of a supportive and positive REIT legislative framework.

A research paper by Ooi et al. (2006) pointed out that some Asian governments view REITs as a vehicle that would 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.

INCREASING TAX REVENUES

Some governments are concerned that they will lose tax revenue. However, according to the UK HM Treasury and Inland Revenue Department (2004), favourable tax treatment at the REIT level does not create a net loss in tax revenue, but rather just makes REITs competitive with direct property investment. According to the HM Treasury and Inland Revenue Department's (2004) discussion paper on the possible introduction of REITs in the UK, the tax treatment "ensures investors are able to make decisions about the appropriate form of property investment based on risk and return profiles, without tax having a disproportionate influence".

Although there might be some tax leakages on 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 revenues (e.g. transaction levies, securities trading).

A KPMG report (2010) pointed out that the policy decision by the Singaporean government to provide incentives for REITs has played a significant role in the growth and development of the REIT market in Singapore. The raised profile of Singaporean capital markets along with job creation resulted from an improved and incentivised REIT market. "In short, the overall economic benefits enjoyed by Singapore far outweigh the tax leakage".

The various economic activities generated because of an increased number of tenants also provide tax revenue indirectly. This is particularly true when the REITs also contribute towards creating new industries, such as modern logistics or IT, by creating new real estate niches which serve these industries.

Some markets, such as Hong Kong, do not provide tax incentives to REITs. This is because Hong Kong does not have a dividend tax, and thus, if REITs were given tax-free status, income will potentially go through the ownership chain without ever being taxed. This structure places REITs in Hong Kong at a disadvantage.

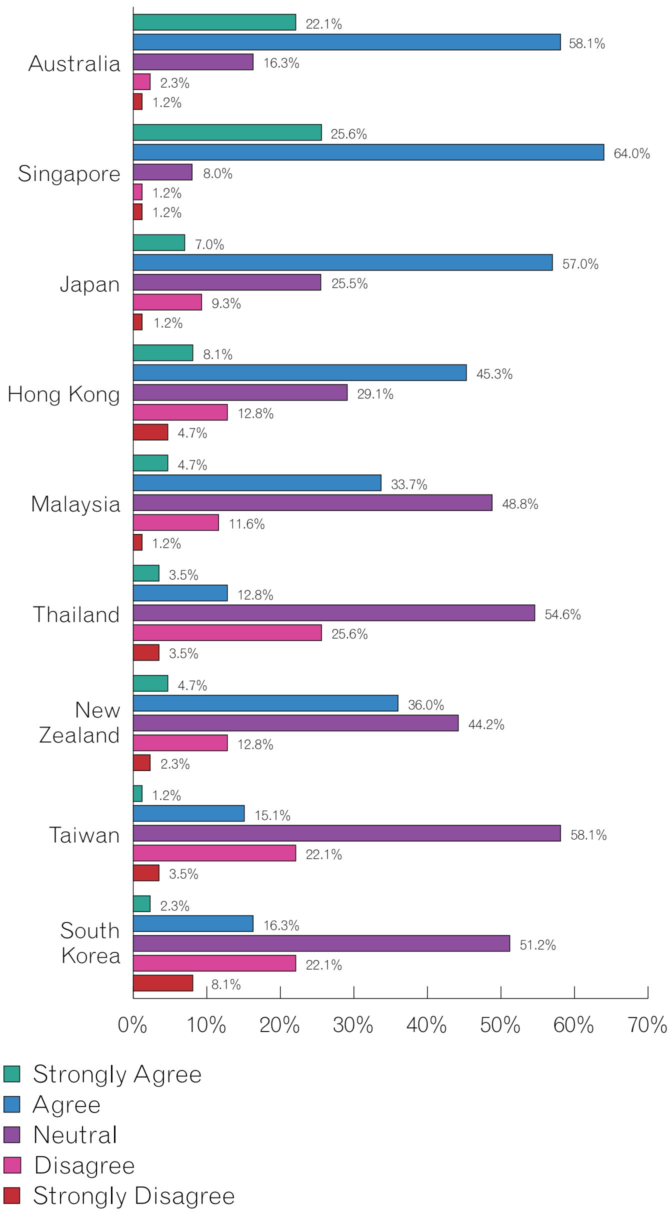
Since Hong Kong REITs are faced with operational restrictions similar to REITs in other countries, many real estate operators prefer to remain in a standard corporate structure, sustaining a class of stock-exchange listed landlords. However, these landlords may face higher costs of capital than their REIT counterparts, precisely because of the lack of operational restrictions.

The APREA (2013) survey showed that property market executives believe that established REIT markets such as Australia, Singapore, Japan and Hong Kong are more conducive for investments, reflecting higher levels of transparency and sound corporate governance structures.

CONDUCIVE REGIMES AND INVESTMENT FLOWS

Taiwan and South Korea carry a heightened level of uncertainty surrounding the regulatory regimes reflecting their relatively recent introduction. Results from the survey are presented in Chart 19.

Chart 19 – REIT regulatory regimes regarded as conducive

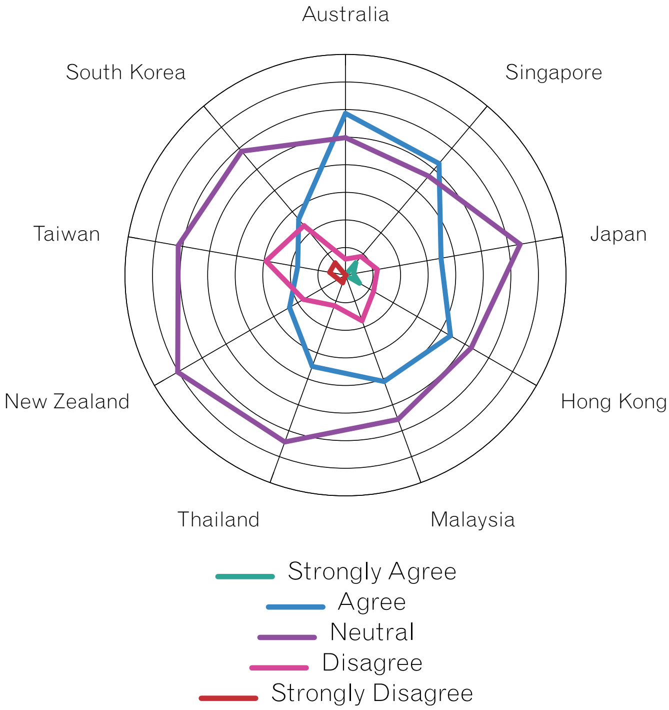


Source: APREA 2013

The APREA (2013) survey reports that improved transparency, sound corporate governance, disclosure, lower management fees, and ability to participate in development projects are features that would increase investor interest in the REIT sector.

The APREA (2013) survey also showed that most respondents intend to increase their allocation to Asian REIT markets over the next three years, with a bias towards established REIT markets such as Australia, Singapore, Japan and Hong Kong, as shown by Chart 20.

Chart 20 – Intention to increase future allocation to Asian REITs



Source: APREA 2013

CLOSING THOUGHTS

The study establishes how REITs have become a valuable option for long-term institutional and individual investors, how they have contributed to capital market diversity and development, and how they have become a positive force in the healthy development of property markets.

It identifies a number of benefits that REITs have brought to economies including:

- They offer institutional and individual investors liquid exposure to income generating real estate
- They attract capital
- They enjoy a relatively low cost of capital
- They have helped to improve market transparency
- They have helped to improve the quality of real estate assets
- They unlock capital, generating additional economic output and creating more jobs

REITs offer institutional and individual investors liquid exposure to income-generating real estate. Real estate has investment characteristics that are distinct from equities and bonds, and so offer diversification benefits in a mixed portfolio. This means REITs are an investment that can help investors achieve better return/volatility outcomes. Pension funds and insurance companies have long valued real estate investment for its steady income and potential for capital gain. REITs allow both institutional and individual investors to access this investment sector in a more manageable quantity and with the benefit of better liquidity.

These distinctive performance characteristics challenge the investment strategies of some institutional investors who have no separate allocation to REITs, simply regarding them, if at all, as part of their equities allocation.

REITs attract capital, including foreign capital, into the property sector by creating a new and attractive vehicle for institutional and individual investors to invest in commercial real estate. REITs enjoy a relatively low cost of capital because of several factors, including liquidity, mandated dividends, tax treatment and limits on borrowing and development risk. By selling stabilised assets to REITs, property developers can unlock capital that can be more effectively deployed in new development projects. Beyond the capital markets activity, this generates real economic output and creates new jobs in high value areas such as asset management, investment appraisal, REIT management, legal and trustee services, investment banking, development management and construction.

Being dedicated landlords, REITs are often associated with improving the quality of real estate assets via refurbishments, asset repositioning and other enhancements. This translates to a better environment for tenants and for the community at large. Over the medium term, this feeds through into deeper professional expertise of asset managers and related professions.

REITs also support the healthy development of the property industry by improving market transparency. As listed vehicles they have significant disclosure obligations, thereby improving the capacity of all industry players to plan responsibly and helping to smooth out property cycles.

For the reasons outlined above, many Asian countries are looking to introduce REIT legislation or enhance their existing REIT regimes. Although some governments fear a loss of tax income because of tax transparency that underpins the attraction and success of the REIT product, the report shows that REITs can actually encourage higher tax revenues. It establishes that the resultant increased economic activity and job creation far outweigh any impact of tax concessions.

The authors are encouraged to see the initiatives in Hong Kong in recent months. In November 2013, the Financial Services Development Council released a series of recommendations for the REIT markets. Many of these recommendations reflect the findings in this report. In January 2014, furthermore, the Securities and Futures Commission initiated a consultation process to consider proposals to amend the Code on Real Estate Investment Trusts, one of which is to permit limited development activity. We believe that this is a welcome step in the right direction.

APPENDICES
& REFERENCES

APPENDIX A: COMPARISON OF REIT STRUCTURES

A comparison of the features across countries that have introduced REIT structures is presented below:

	Australia	Belgium	Canada	France
Listing requirements	Nil	Min. free float of 30%	Min. 150 unit holders. In order to list on the TSX, 1 million free trading shares and 300 public shareholders. Non-residents must own <50%	One shareholder or several shareholders acting in concert cannot own more than 60%
Real estate investment restrictions	Flexible	100% real estate	75% of revenues from rents or capital gains from disposition of real properties	Flexible
Exchange controls	No	No	No	No
Property development	Tax as company	Allowed, but must not sell before 5 years	Prohibited	Restricted up to 20% of gross book value
Gearing restrictions	No restrictions	65% of total assets. Interest expense limit 80% total	No restrictions	No restrictions
Distributions	No restrictions. Income not paid is taxable at REIT	At least 80% of net profit	No restrictions. Income not paid is taxable at REIT	At least 85% of tax-exempt profits. 50% of capital gains. 100% of dividends annually
Structure	Trust	Corporate	Trust	Corporate/ Partnership Co. limited by shares
Tax transparency	Yes	Yes	Yes	Yes. Ancillary activities are subject to the standard corporate rate
Withholding tax	Yes	Yes	Yes	Yes
Foreign investment control	Investable subject to restrictions	Investable	Significant restrictions	Investable

Source: UBS, EPRA, CBRE, PwC

Appendix A – REIT structures (continued)

	Germany	Hong Kong	Italy	Japan	South Korea
Listing requirements	Min. free float of 15%. In regard of the 85% free-float, a single shareholder is not allowed to own more than 10%	Nil	35% min. free float. Single shareholder <51%	TSE rules: lead investor should hold 75% or less. At least 1,000 investors	30% min. free float. Single shareholder <30%
Real estate investment restrictions	75% real estate	100% real estate and at least 90% in income producing assets	80% real estate	70% real estate	70% real estate
Exchange controls	No	No	No	Yes	Yes
Property development	Restricted	Prohibited	Not exempt from tax	Prohibited	Limit 30% of assets
Gearing restrictions	55% loan to value	45% of gross asset value	Interest expense deduction is limited.	No restrictions	Limit to 200% of equity
Distributions	At least 90% of profit and half of realised gains	At least 90% of net income after tax	85%+ of taxable income from rentals annually	At least 90% of distributable profits to qualify for dividend payment deduction	At least 90% of distributable income
Structure	Corporate	Trust	Corporate	Trust or Corporate type (all listed JREITs are Corporate type)	Corporate
Tax transparency	Yes	No	Yes	Yes	Yes
Withholding Tax	Yes	No	Yes	Yes	Yes
Foreign investment control	Investable	Investable	Investable	Investable subject to approval	Investable with some restrictions

Source: UBS, EPRA, CBRE, PwC

Appendix A – REIT structures (continued)

	Malaysia	Netherlands	Singapore	Taiwan
Listing requirements	REIT initial size should be at least MYR100million	Min. 75% free float. Single shareholder, up to 45% of shares	At least 25% of capital must be held by at least 500 public unit holders	Any five shareholders shall not own more than 50%
Real estate investment restrictions	At least 50% real estate. Non real estate assets must not exceed 25% of total asset value	100% real estate	At least 75% of deposited property should be invested in income-producing real estate	Investment and utilisation limited according to Article 17 of the RESA
Exchange control	No	No	No	Yes
Property development	Allowed to enter into an arrangement to acquire real estate under construction provided that purchase agreement is made subject to completion of the building and that total value of real estate under construction does not exceed 10% of the fund's total asset value	Only if REIT intends to use for rental income	No more than 10% of total assets and REIT needs to hold the developed property upon completion	Prohibited
Gearing restrictions	50% of total asset value	60% of book value of property assets	35% of total asset without a credit rating. 60% with credit rating	35% of total assets
Distributions	At least 90% of taxable income to qualify for tax transparency	100% of taxable profit	At least 90% of taxable income to qualify for tax transparency	100% of distributable income
Tax transparency	Yes	Yes	Yes	Yes
Withholding Tax	Yes	Yes	Yes	Yes
Foreign investment control	Restricted	Investable	Investable	Restricted

Source: UBS, EPRA, CBRE, PwC

Appendix A – REIT structures (continued)

	Thailand	Turkey	UK	US
Listing requirements	Persons in same group shall not hold more than 50% of total units	Min. 25% free float. At least one promoter to own min. 20% of capital	Min. 35% free float. A single corporate shareholder cannot own more than 10% of shares or voting rights	Five or fewer individuals cannot own 50% or more of total shares. At least 100 shareholders
Real estate investment restrictions	75% of assets in real property	50%+ of assets. Cannot commercially operate hotel, hospital, shopping centre, etc.	75%+ of earnings and asset value. Hold at least three separate assets. No one asset to exceed 40% of total assets	75% of investments must be real estate, govt. sec or cash. 95+% income rule applies
Exchange control	No	No	No	No
Property development	No more than 10% of total assets	No	Yes for renting out	Yes
Gearing limit	35% of total asset without a credit rating. 60% with an investment grade credit rating	Short term credits limited to 3x NAV	1.25x interest cover	No restrictions
Distributions	At least 90% of adjusted net profit	Min. 20% of distributable profits	At least 90% of rental asset income	At least 90% of taxable income
Withholding tax	Yes	No	Yes	Yes
Foreign investment control	Restrictions	Investable with some restrictions	Investable	Investable

Source: UBS, EPRA, CBRE, PwC

Appendix A – REIT structures (continued)

	Indonesia	Philippines
Listing requirements	Major shareholder cannot hold more than 75%	Paid up capital of PHP300million. At least 1,000 public shareholders
Real Estate Investment Restrictions	50% of NAV in real estate and 80% of NAV in real estate and real estate-related assets	75% of deposited property in income-producing real estate
Exchange control	No	No
Property development	Prohibited	No more than 10% of total assets and REIT needs to hold the developed property upon completion
Gearing limit	20%	35% of total asset without a credit rating. 60% with credit rating
Distributions	At least 90% of net profit after tax	At least 90% of net profit after tax
Tax transparency	N/A	No
Withholding tax	N/A	Yes
Foreign investment control	N/A	Investable but cannot exceed 40% of deposited property

Source: UBS, EPRA, CBRE, PwC

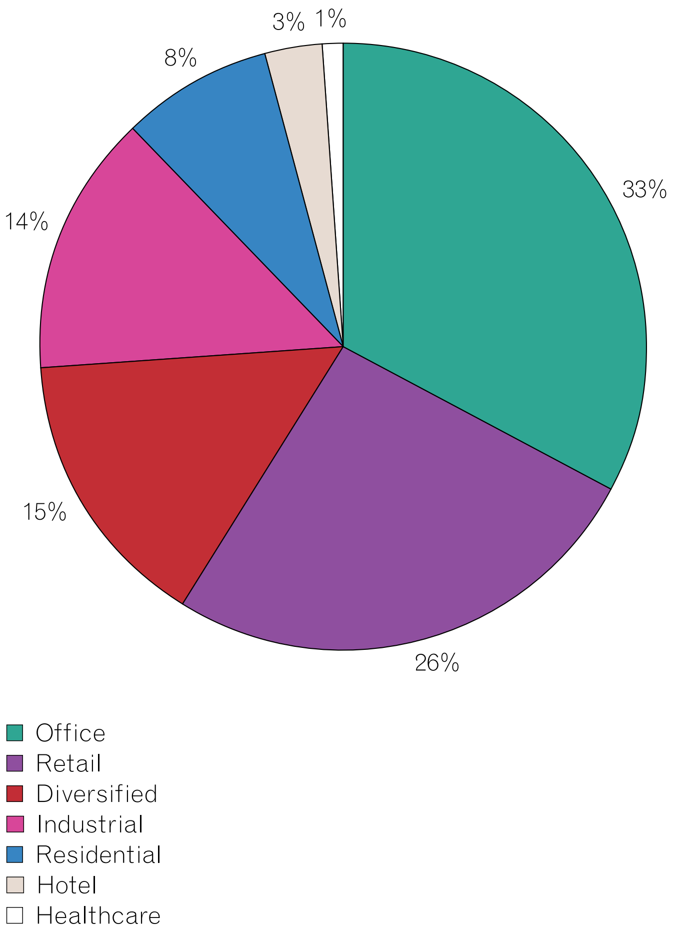
APPENDIX B: TYPES OF REIT

A brief description of the most common categories of REITs follows:

Equity REIT

This is the most common type of REIT and invests in and owns properties, with revenues most commonly coming from rental collections. Equity REITs take ownership positions in real estate investments.

***Chart 1** – Asian REIT sector composition by free float market capitalisation*



Source: GPR. APREA (31 December 2013)

Property sectors

Investments within a REIT may be particular to a region, country, sector or a combination. Sectors in which REITs typically invest are:

- Residential
- Office
- Industrial
- Retail
- Hotel
- Healthcare

Cross-border REIT

Cross border REITs are listed on stock exchanges and have at least some assets outside the country of listing. Cross border investments facilitate regional integration of real estate markets. Cross border listings may access an enlarged investor base for capital raising.

Empirical studies from Foerster and Karolyi (1999) and Errunza and Miller (2000) find a strong negative impact of cross border listings on the cost of capital. This reflects the complexity of determining the risk free rate for a REIT holding real estate in another country.

APPENDIX C: GLOBAL APPRAISED PROPERTY INDEX

Benchmark

The Global Appraised Property Index (GAPI) has been developed by Atchison Consultants as a measure of the aggregate market movement of direct property investments throughout the major economies.

Purpose

The GAPI is intended to be used for three purposes:

- Broad measure of property performance on a global and regional basis
- Input into portfolio construction analysis using returns, volatility of returns, and correlations of returns with other asset classes
- Gauge of relative performance of investment portfolios and attribution analysis

Basis

- Commencement date 31 December 1984, creating 28 years of history
- Measured annually
- Includes 24 major economies
- Representation of 89% of High Income OECD economies (as defined by World Bank)
- Country indices used, or rental and capital yields used in absence of available indices
- Countries re-weighted by GDP
- Measured in AUD, USD, Japanese Yen, Local (hedged) or any other major currency, as required
- Includes all major property types (office, retail, industrial, residential)
- Benchmark available excluding home country benchmark, e.g. excluding US
- Latest data to 31 December 2012

REFERENCES

Ambrose, B.W., and P. Linneman (2001), "REIT Organisational Structure and Operating Characteristics", Journal of Real Estate Research, 21(3), 141-162

ARES (2012), "Economic Effects from Real Estate Investment Market"

ARES (2012), "Study Group on Growth of J-REIT Market"

Asia Pacific Real Estate Association (2013), "Performance Characteristics of Asia Pacific's REIT Markets"

Asia Pacific Real Estate Association and Atchison Consultants (2012), "Benefits of LSRE to the Indian Economy"

Atchison Consultants (2013). "Global Listed Property Leads Global Direct Property", Atchison Consultants Global Property Forum, 2013.

Aveline-Dubach, Natacha, Hisotoshi Ai, and Yasushi Asami (2012), "New Patterns of Investment under Real Estate Securitization: Evidence from the Tokyo Market"

Barna, F. and P. Mura (2010), "Capital Market Development and Economic Growth: The Case of Romania", Annals of the University of Petroşani, Economics, 10(2), 2010, 31-42

Beatty, A, K Ramesh, and J Weber (2002), "The Importance of Accounting Changes in Debt Contracts: The Cost of Flexibility in Covenant Calculations", Journal of Accounting & Economics 33:205-227

Bekaert, G., and C.R. Harvey (2000), "Capital Flows and the Behaviour of Emerging Market Equity Returns", published in Capital Flows and the Emerging Economies: Theory, Evidence, and Controversies, NBER Books

Brasoveanu, L.O, Dragota, V., Catarama, D. and A.Semescue (2008), "Correlations between Capital Market Development and Economic Growth: The Case of Romania", Journal of Applied Quantitative Methods, 3(1), 2008, 64-76

Carlin, W. and C. Mayer, (2003), "Finance, Investment, and Growth", Journal of Financial Economics, 69, 2003, 191-226

Capozza D.R. and P.J. Seguin (2000), "Debt, Agency, and Management Contracts in REITs: The External Advisor Puzzle", The Journal of Real Estate Finance and Economics, 20(3), 2000, 91-116

Clayton, J., Fabiozzi, F.J., Gilberto, S.M., Gordon, J.N, Hudson-Wilson, S., Hughes W., Liang, Y., MacKinnon, G., and A.Mansour, (2011), "The Changing Face of Real Estate Investment", The Journal of Portfolio Management, 37(5), 2011, 12-25

Conner, Philip (2004), "UK REITs – A Step in the Right Direction", Prudential Real Estate Investors

Conner, Philip and Marc Halle (2006), "Asian REITs: A New Dimension for Investors", Prudential Real Estate Investors

Conner, Philip and Youguo Liang (2005), "Global REITs: A new Platform of Ownership", Prudential Real Estate Investors

Deloitte (2010), "REITs and infrastructure projects: The next investment frontier?"

Demirguc-Kunt, A. and R. Levine, (1996a), "Stock Market Development and Financial Intermediaries: Stylized Facts", World Bank Economic Review, 10(2) 291-321

Diamond, D.W, and R.E Verrecchia (1991), "Disclosure, Liquidity, and the Cost of Capital", Journal of Finance, 46:1325-1359.

Errunza, V. and D. Miller (2000), "Market Segmentation and the Cost of Capital in International Equity Markets", Working Paper Series

Fidelity (2006), "The Case for Global Property Securities", Investment Intelligence from Fidelity

Foerster, S. and G. A. Karolyi (1999), "The Effects of market segmentation and investor recognition on asset prices: Evidence from Foreign Stocks Listing in the United States", Journal of Finance, 54, 1999, 981-1013

Glascock, John and Julie Cowans (2004), "Consultation response to HM Treasury on promoting more flexible investment in property", Joseph Rowntree Foundation

Harvey, Joseph (2010), "The Truth About Real Estate Allocations", Cohen & Steers

Hebb, Tessa, David Wodd and Ashley Hamilton (2009), "Responsible Property Investing and Property Management: Exploring the Impacts of Good Labour Practices on Property Performance"

HM Treasury – United Kingdom (2004), “Barker Review of Housing Supply”

HM Treasury and Inland Revenue – United Kingdom (2004), “Promoting more flexible investment in property”

HM Treasury and Inland Revenue Department (2005), “UK Real Estate Investment Trusts: a discussion paper”, pp 5-6

Ibbotson Associates (2002), “Diversification Benefits of REITs”, NAREIT

Jones Lang LaSalle (2012), “Global Real Estate Transparency Index: Global Foresight Series 2012”

KPMG (2010), “Taxation of Real Estate Investment Trusts: An overview of the REIT regimes in Europe, Asia, the United States and Canada”

Lecomte, P. (2012), “Asian Commercial Real Estate as an Inflation Hedge – A Multi Country Multi Asset Class Analysis”, APREA

Ling, D.C., and A. Naranjo (1999), “The integration between commercial real estate markets and stock markets”, Real Estate Economics, 44(3), 483-513

Manap, T., Abduh. M, and M.A Ohmar (2012), “Islamic Banking-Growth Nexus: Evidence from Toda-Yakamoto, and Bootstrap Granger Causality Test”, Journal of Islamic Finance, 1(1), 59-66

Mihaljek, D. (2008), “The financial stability implications of increased capital flows for emerging market economies”, published in Bank of Institutional Settlements’ Financial globalisation and emerging market capital flows, 2008, 44, 11-44

NAREIT and Wilshere Associates (2012), “The role of REITs and Listed Real Estate Equities in TDF Asset Allocations”, pp 46

NAREIT (2010), “Special Report. REITS: Real Estate With A Return Premium”

NAREIT (2011), “REITs, Private Equity Real Estate and the Blended Portfolio Advantage”

NAREIT (2011), “Letter to the California Public Employees’ Retirement System”

NAREIT (2011), “The Investor’s Guide to REITs”, pp 5

OECD (2012), “ECONOMIC POLICY PAPERS, NO. 3: Looking to 2060: Long-term global growth prospects”

Ooi, J.L, Newell, G, and T.F. Sing (2006), “The Growth of REIT markets in Asia”, Journal of Real Estate Literature, 14(2), 203-222

Op’t Veld, Hans (2005), “Does Tax Transparency Pay?”

PriceWaterhouseCoopers (2009), “Worldwide Real Estate Investment Trust (REIT) Regimes Country Summaries”

PwC (2012), “The Socioeconomic impact of SIICs in France”, pp 3

PwC (2012), “Listing Real Estate in Singapore – Singapore tax aspects for REITs and Business Trusts”

PwC and Landwell & Associates (2012), “Report on the tax contribution of the SIIC”

RREEF (2007), “Global Real Estate Securities – The emergence of a discrete asset class”

Trust Company and Baker & McKenzie (2011), “Asia-Pacific REIT Survey April 2011”, pp 17

United Nations (2012), “World Population Ageing : 1950- 2050”, Department of Economic and Social Affairs Population Division

US House of Representatives (2010), “House Resolution 1595”

W.K. Nowlan & Associates (2011), “A REIT Structure For Ireland”

Yeung, Victor S. (2013), “Admiral’s Field Notes: REITs and Rental Real Estate”, YAA Publishing

UBS (2013), “Global Real Estate Analyser – 2014 Outlook”

ASIA PACIFIC REAL ESTATE ASSOCIATION LIMITED
REG. NO. 201116215Z

REPRESENTING AND PROMOTING THE ASIA PACIFIC REAL ESTATE ASSET CLASS
WWW.APREA.ASIA