Cross-border REITs: Opportunities and Challenges

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27 March 2006

A presentation to Chinese Real Estate Chamber of Commerce (CRECC)
By Invitation of Pacific Star China Limited

Cross-border REITs:
• How?
  • Why?
  • Who? Where?
Presentation Outline

- Emerging of REITs in Asia
- Cross-border REITs
- Motivations for cross-border REITs
- Pull and Push Factors for Cross-border REITs
- Investment strategies of institutional investors and cross-border REITs
- Potential of setting-up China REITs

Emerging REIT markets in Asia

- Relatively short history of development compared to the US and Australia markets
- Started in 2001 with the first Japanese REIT, Nippon building Fund Inc, listed on the Tokyo Stock Exchange (TSE)
- Currently 54 REITs across seven countries
- Combined market capitalization of US$33.9 billion, which constitutes only 8.42% of the world market share (excl European markets)
- Japan is the largest market with 25 J-REITs with a market capitalization of US$22.8 billion
- Singapore has the second largest market share of 19.7% in Asia (US$6.67 billion – 4Q2005)
- Hong Kong is catching up fast with 3 REITs currently listed and several in the pipelines
Market share of Asian REITs (as at 4th quarter 2005)

<table>
<thead>
<tr>
<th>Region</th>
<th>Market Capitalization (US$ mil)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>US$ 33,892</td>
<td>84.2%</td>
</tr>
<tr>
<td>Australia</td>
<td>US$ 60,860</td>
<td>15.11%</td>
</tr>
<tr>
<td>US</td>
<td>US$ 307,895</td>
<td>76.4%</td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td>67.3%</td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td>0.5%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td></td>
<td>8.9%</td>
</tr>
<tr>
<td>Korea</td>
<td></td>
<td>1.7%</td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td>19.7%</td>
</tr>
<tr>
<td>Thailand</td>
<td></td>
<td>1.4%</td>
</tr>
<tr>
<td>Taiwan</td>
<td></td>
<td>0.5%</td>
</tr>
</tbody>
</table>

Size of Singapore REIT market (as at 4th quarter 2005)

By Property Sector Distribution

- Retail: 31%
- Industry/Logistics: 38%
- Mixed (Office/Retail): 20%
- Office: 11%
What are cross-border REITs?

Cross-border REITs are either listed/traded in overseas stock exchanges or invest in real estate assets in one or more countries outside their home base.

- Represented by REITs in shaded boxes.
- The origin of the sponsor is not a relevant factor in determining the cross-border status.

<table>
<thead>
<tr>
<th>Asset Holdings</th>
<th>Home country</th>
<th>Overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMT, A-REIT,</td>
<td>Fortune REIT,</td>
<td></td>
</tr>
<tr>
<td>CCT, Suntec REIT,</td>
<td>GZI REITs</td>
<td></td>
</tr>
<tr>
<td>MEAG PrimeREIT,</td>
<td>MapleTree Logistics REIT</td>
<td></td>
</tr>
</tbody>
</table>

Cross-border strategy is independent of REIT size

Evidence from US REITs (1985-1992)

<table>
<thead>
<tr>
<th>REITs by size</th>
<th>1st quartile</th>
<th>2nd quartile</th>
<th>3rd quartile</th>
<th>4th quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average total asset ($million)</td>
<td>29</td>
<td>70</td>
<td>124</td>
<td>279</td>
</tr>
<tr>
<td>Value-weighted premium (%)</td>
<td>-24.70%</td>
<td>-14.40%</td>
<td>-3.70%</td>
<td>8.40%</td>
</tr>
<tr>
<td>Leverage ratio (%)</td>
<td>30.00%</td>
<td>31.00%</td>
<td>37.00%</td>
<td>38.00%</td>
</tr>
<tr>
<td>Property concentration index (%)</td>
<td>72.80%</td>
<td>60.60%</td>
<td>59.20%</td>
<td>65.50%</td>
</tr>
<tr>
<td>Regional concentration index (%)</td>
<td>-53.90%</td>
<td>58.50%</td>
<td>55.80%</td>
<td>59.00%</td>
</tr>
<tr>
<td>General &amp; Administrative Expenses/Total Asset (%)</td>
<td>1.70%</td>
<td>1.40%</td>
<td>1.20%</td>
<td>0.90%</td>
</tr>
<tr>
<td>Cash Flow Yield (%)</td>
<td>8.60%</td>
<td>7.70%</td>
<td>8.50%</td>
<td>7.90%</td>
</tr>
</tbody>
</table>

Small REITs are more highly concentrated by property type.

No significant variation in regional distribution for REITs of different size.

Source: Capozza and Lee (1995)
Warehouse REITs are more likely to have "cross-border" portfolios

Evidence from US REITs (1985-1992)

<table>
<thead>
<tr>
<th>REITs by type</th>
<th>Office</th>
<th>Warehouse</th>
<th>Retail</th>
<th>Apartment</th>
<th>Diversified</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average total asset ($million)</td>
<td>102</td>
<td>64</td>
<td>162</td>
<td>173</td>
<td>142</td>
</tr>
<tr>
<td>Value-weighted premium (%)</td>
<td>-7.50%</td>
<td>-24.20%</td>
<td>-1.10%</td>
<td>-10.70%</td>
<td>-8.70%</td>
</tr>
<tr>
<td>Leverage ratio (%)</td>
<td>31.00%</td>
<td>39.00%</td>
<td>34.00%</td>
<td>54.00%</td>
<td>32.00%</td>
</tr>
<tr>
<td>Property concentration index (%)</td>
<td>69.20%</td>
<td>68.30%</td>
<td>71.60%</td>
<td>64.50%</td>
<td>34.70%</td>
</tr>
<tr>
<td>Regional concentration index (%)</td>
<td>58.70%</td>
<td>37.90%</td>
<td>62.50%</td>
<td>80.20%</td>
<td>52.30%</td>
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<td>General &amp; Administrative Expenses/Total Asset (%)</td>
<td>1.10%</td>
<td>1.20%</td>
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<td>0.80%</td>
<td>1.60%</td>
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<td>Cash Flow Yield (%)</td>
<td>7.50%</td>
<td>8.70%</td>
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<td>8.20%</td>
<td>8.50%</td>
</tr>
</tbody>
</table>

Warehouse REITs are relatively small in term of asset size, and the assets are well diversified by geographical regions.

Source: Capozza and Lee (1995)

Cross-border Strategies for REITs

- Diversification options
  - Expanding existing portfolios of REITs to include overseas property
  - Mapletree Logistics REITs
- Offshore listing while keeping asset portfolio focused in home base
  - Fortune REITs (Singapore), GZI REITs (Hong Kong)
- Onshore listing in home country where assets are based
  - Exporting expertise
  - Maximizing institutional/ tax advantages in listing countries
Potential cross-border REITs in the pipeline

- Potential new listing of REITs with assets distributed across countries
  - Mapletree Pan-Asia Industrial REIT (2007)
  - Lippo Group
  - CDL’s Millennium & Copthorne Hotels REIT

- Foreign REIT planned for listing in foreign exchanges
  - Allco REIT (Singapore)
  - Legend Holdings (parent of Lenovo group) (Hong Kong)

- Expansion of existing REITs’ portfolio to include overseas assets
  - CCT and MEAG Prime REIT may expand portfolio to include overseas properties

Motivations for Cross-border REITs

- REIT listed in foreign exchanges
  - Access to international capital (equity and debt)
  - Optimize asset value - Positive signaling
  - Increase exposure via institutional ownership of REIT shares

- REITs with geographically diversified portfolios (spread by markets)
  - Portfolio diversification benefits
  - Smoothing out cyclical risks
  - Access to larger pool of assets with attractive yields
Factors motivating S-REITs in cross-border acquisitions

- Small size of the property market in Singapore
  - Limits supply of quality income-generating properties - tightly held by owners/developers
  - Competitive bids drive down property yields in home markets
- Economics of scale for selected sectors eg. service apartment, logistics
- Diversification/ risk reduction
- Pulls from overseas property markets
  - Larger pool of yield accretive acquisitions in emerging markets
  - First mover advantage in overseas markets

Does diversification affect the returns of cross-border REITs?

- Diversification across borders does not affect total expenses
  - Diversification by property type however increases style expenses
  - Style expenses are related to managerial effort in focus/diversification strategies
  - Increase expenses are compensated by higher return
  - Investors view investment as zero-NPV projects
  - (Capozza and Seguin, 1998 and 1999)
- Diversification affects liquidity of REIT
  - Less focused firms are harder to value and monitor
  - Information is more costly to collect, agency cost increases and liquidity reduces
  - Lower cost of capital for focused REITs
Cross-border REITs in institutional investors’ portfolio

- Expected rate of returns from cross-border REITs
- Cost of diversification in regional portfolio
  - Internal vs external strategy
- Does diversification matter?
  - Evidence in the US suggest otherwise (Gyourko and Nelling, 1996)
- Will the story of capital cost prevail over the diversification story?
  - No empirical evidence
- Expected outcome: possible clientele effects exist
  - Institutional vs retail investors

Internal vs external diversification strategies

A) Investment in Diversified REITs

Investor A

- REIT 1 ($400mil)
  - Apartment (1/4)
  - Office (1/4)
  - Retail (1/4)

Investor B

- REIT 2 ($400mil)
  - Apartment (1/4)
  - Office (1/4)
  - Retail (1/4)

Investor C

- REIT 3 ($400mil)
  - Apartment (1/4)
  - Office (1/4)
  - Retail (1/4)

Investor D

- REIT 4 ($400mil)
  - Apartment (1/4)
  - Office (1/4)
  - Retail (1/4)

B) Investment in Focused REITs

Investor A

- REIT 1 ($400mil)
  - Apartment

Investor B

- REIT 2 ($400mil)
  - Office

Investor C

- REIT 3 ($400mil)
  - Retail

Investor D

- REIT 4 ($400mil)
  - Industrial

Positive factors in setting-up a China REIT market

- Barriers of entry into the REIT game:
  - Absence of legislative framework for REITs
  - Lack of developed pool of asset and fund management expertise
  - Title and tenure security

- However, there are positive underlying factors for a China REIT market:
  - Influx of foreign direct investment into real estate through private funds
  - Availability of a large pool of quality real estate
  - Strong demand by foreign investors on real estate investment in China
  - Liberalization of economic and accession to WTO
  - Government’s effort to broaden and deepen capital market
  - Increased demand for real estate development financing
  - Rapid growth in urbanization

Strategies in developing a viable China REIT market

- Foreign REITs / Real Estate Funds
  - Set up joint-venture private real estate funds by real estate developers in China and foreign REITs, which may adopt a limited liability partnership structure

- REITs listed in China bourses (Foreign REITs owning real estate portfolio in China)

- Cross-border REITs (listed in China)
  - Fully liberalize the markets for local and foreign funds to list REITs in China bourse
  - To allow China listed REITs to expand and venture into overseas real estate markets

- Process towards a fully liberalized REIT market in China

Source of Capital Funds

- Offshore capital
- China onshore market

Accessibility to Real Estate Market

- Limited access to foreign investors
- Fully open to foreign investors

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**Feasibility of bringing China properties offshore**

- As an interim strategy while China REIT laws are still being developed
- Some considerations:
  - Relaxations of regulations in disposal and transfer of ownerships of properties in China
  - Avoid “lemon” problems – issues of “adverse selection”
    - Realization of full value of properties
    - Selection of quality properties for the portfolio
    - Disclosure and transparency
  - How?
    - Engaging/partnering reputable asset/fund management companies in overseas listing
    - Adoption international accepted standard in valuation and asset management
    - Cornerstone investors/major institutional investors
    - Pricing of assets/IPO

**Offshore listing for China REITs – Asia REIT hub race**

- Singapore and Hong Kong are two most conducive markets for overseas listing of REITs
- Singapore has an early head-start
- Hong Kong is catching up soon
- Institutional/ regulatory frameworks for both markets are comparable
- Hong Kong has proximity advantage
- Important factors for consideration:
  - Cost of capital – both debt and equity
  - Transaction costs/ listing costs
  - Market stability and transparency
## Comparison of the REIT legislative framework

<table>
<thead>
<tr>
<th>Country</th>
<th>Singapore</th>
<th>Hong Kong</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listing of first REIT</td>
<td>17-Jul-02</td>
<td>18-Nov-05</td>
</tr>
<tr>
<td>Asset management structure</td>
<td>External</td>
<td>Internal / External</td>
</tr>
<tr>
<td>Minimum real estate asset requirement</td>
<td>70%</td>
<td>90%</td>
</tr>
<tr>
<td>Dividend policy/minimum distribution</td>
<td>90%</td>
<td>90%</td>
</tr>
<tr>
<td>Gearing limit (% of total asset)</td>
<td>35% to 60% (A rating)</td>
<td>45% (wef 17 Jun 05)</td>
</tr>
<tr>
<td>Development activities?</td>
<td>Yes &lt; 10% of total asset</td>
<td>Prohibited</td>
</tr>
<tr>
<td>Overseas property investment?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Tax transparency:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) REIT level</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>b) Investor level</td>
<td>Yes (for individuals local and foreign)</td>
<td>Yes</td>
</tr>
</tbody>
</table>

## Drawing Cross-border listing to Singapore

- A well established legal framework
  - One of the earliest REIT markets in Asia with the first REIT listed in 2002
- Strong government support
- Tax incentives to attract regional REITs
- Market acceptance of REITs
  - REITs are traded at attractive premiums to NAV
- A pool of experience and asset and fund managers
S-REITs are traded at Premium to NAVs (as at FY ended 2003)

<table>
<thead>
<tr>
<th>Company</th>
<th>Discount/Premium to NAV (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASCOTT</td>
<td>-22.96%</td>
</tr>
<tr>
<td>BONVEST HOLDINGS</td>
<td>-63.80%</td>
</tr>
<tr>
<td>CAPITALAND</td>
<td>-25.06%</td>
</tr>
<tr>
<td>CHEMICAL INDL. (FE.)</td>
<td>-40.84%</td>
</tr>
<tr>
<td>CHINA MERCHANTS HDG.</td>
<td>-24.58%</td>
</tr>
<tr>
<td>CITY DEVELOPMENTS</td>
<td>-44.97%</td>
</tr>
<tr>
<td>GUOCOLAND</td>
<td>-24.44%</td>
</tr>
<tr>
<td>HETTON HDG.</td>
<td>-39.06%</td>
</tr>
<tr>
<td>HO BEE INVESTMENT</td>
<td>-29.95%</td>
</tr>
<tr>
<td>KEPPEL LAND</td>
<td>-35.76%</td>
</tr>
<tr>
<td>L C DEVELOPMENT</td>
<td>-31.12%</td>
</tr>
<tr>
<td>MCL LAND</td>
<td>-36.85%</td>
</tr>
<tr>
<td>ORCHARD PARADE HDG.</td>
<td>-47.57%</td>
</tr>
<tr>
<td>SC GLOBAL DEV.</td>
<td>-80%</td>
</tr>
<tr>
<td>UNITED OVERSEAS LAND</td>
<td>-67.68%</td>
</tr>
<tr>
<td>WHEELOCK PROPS.</td>
<td>-60%</td>
</tr>
<tr>
<td>WING TAI HOLDINGS</td>
<td>-40%</td>
</tr>
<tr>
<td>CAPITALMALL TST.</td>
<td>-20%</td>
</tr>
<tr>
<td>MACQUARIE MEAGREIT</td>
<td>0%</td>
</tr>
<tr>
<td>MAPLETON</td>
<td>0%</td>
</tr>
<tr>
<td>ALLGREEN PROPS.</td>
<td>20%</td>
</tr>
<tr>
<td>ASCOTT GROUP</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: Datastream

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Capitalization Rate (as at 20 March 2006)

The gap of capitalization rate between REITs and property stocks is narrowing

Source: Datastream
Tax concessions for S-REITs

(28 Feb 2005)

- Announced in the 2005 Budget package
- Remission of Stamp Duty
  - Instrument relating to the sale of property to REIT
  - Listed REITs or REITs to be listed on SGX (within one month from date of completion of sale agreement)
  - Effective from 18 February 2005 to 17 February 2010
- Reduction of tax rate on distributions
  - Tax rate on distributions to foreign non-individual investors will be reduced from 20% to 10%
  - Include non-individual who does not have a permanent establishment in Singapore, or one whose funds used in investing REIT are not from the operation of the permanent establishment in Singapore
  - Effective from 18 February 2005 to 17 February 2010

Further tax incentives for Cross-border REITs

- Announced in Budget 2006 on 17 February 2006
- Tax exemption under Sec 13(12) is extended to include
  - foreign-sourced interest income, and
  - foreign trust distributions made out of income or gains from the underlying foreign properties
- Encourage Singapore-listed REITs to invest in foreign properties
- Boost to attract more REITs to be established in Singapore
- Strengthen Singapore as preferred location in Asia for REIT listings
Risks in cross-border listing of REITs

- Foreign exchange risks
- Economic & political stability
- Market framework /infrastructure
  - Pool of experience fund manager
  - Developed benchmarking REITs index
- Differential tax structure & capital control risks
- Liquidity and transparency risks
  - Coverage by analysts
  - Institutional investors and trading volume
  - Transaction costs
- Needs for local knowledge & expertise
- Level of sophistication of investors

Summary

Cross-border REIT....

- How?
  - Onshore (In-country) listing + geographical diversified asset portfolio
  - Offshore listing + home-base asset portfolio
- Why?
  - Risk diversification story is not convincing based on US evidence
  - One caveat on US findings: country and currency risks are not considered
  - Capital market story through offshore listing for China REITs
- Who? Where?
  - Asia REIT hubs: Singapore vs Hong Kong
  - Potential China companies with real estate portfolios
  - Look up for potential risks

Thank you