Challenges Ahead for Singapore Real Estate Investment Trusts (S-REITs)

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The recent debut of Mapletree Logistic Real Estate Investment Trust (MLT) on Singapore Exchange on 28 July 2005 traded at 34.6% above IPO price of S$0.68 (based on the upper range of the first day trading price of S$0.915) has again silver-lined the real estate market in Singapore. It echoed the first day trading performance of the Suntec REIT that was also traded at nearly 30% premium. The newcomer is the sixth addition to listed REITs in Singapore, creating more competition, and at the same time, diversity of choice to both retail and institutional investors. In a dinner marking the listing of MLT, Ms Ho Ching, the chief executive of Temasek Holdings, the parent company of the MLT sponsoring company and a major unitholder of MLT, while optimistic about developing Singapore as a hub to attractive listing of quality Asian REITs, also cautions investors of potential risks involved in investing REITs. This article will further deal in greater details issues of structure and growth strategies of REITs by reflecting on US REIT experience. It would start off with a general overview of the institutional characteristics and performance Singapore-REITs (S-REITs).

Evolution of S-REITs

In the US, REIT was created by Congress in 1960 to allow small investors to have indirect access to large-scale income producing real estate investment. In Singapore, REIT offers an indirect vehicle for developers with large portfolio of low-yield income producing commercial properties to divest the asset holdings and unlock book values of the assets. This is an “exit strategy” for some developers to liquidate their equity stake in real estate projects, such as the divestment of Suntec retail mall and office towers via Suntec REIT that ended the joint ownership relationship of the 11 Hong Kong tycoons that initiated the project in 1988.

The road to a buzzing REIT market today in Singapore was not smooth-sailing. The idea was mooted back in 1986, when Singapore property market was in doldrums following its first post-independent economic recession in 1985. The idea did not take off, but subsequently interest in REIT was re-ignited in late 1990s when the Monetary Authority of Singapore (MAS) revealed the guidelines for Property Funds in May 1999. The first attempt to launch a REIT was made by CapitaLand with its SingMall Property Trust (SPT) in November 2001, but the listing was aborted due to under-subscription of the new issues. Market timing and lack of tax transparency were cited by analysts as the main causes for the lukewarm response to the maiden S-REIT at the time.

In July 2002, SPT was restructured with the same portfolio of three retail properties (Junction 8, Tampines Mall, Funan IT Mall) and re-launched under the new name “CapitaMall Trust” (CMT). The CMT IPOs were priced at $0.96, which was estimated at 2% discount to NAV compared to the earlier attempt that priced the IPO at 2.7% premium. The re-launch of CMT was a success with 5-time oversubscription, and it has been an important cornerstone in the REIT chapter in Singapore. Ascendas-REIT (A-REIT) was subsequently listed on the Singapore Exchange in November 2002, and it IPO was also over-subscribed by 5 times. As of July 2005, there are six...
REITs listed and traded on Singapore Exchange, and their details at IPO are summarized in Table 1.

**REIT Performance and Characteristics**

REIT is intended to be a defensive and recession-centric instrument. REIT return is dependent on revenues generated from income producing properties held in its portfolio. However, in Singapore, REIT is not purely a yield driven product. The total returns indices in Figure 1 show robust price appreciation of S-REITs over the years surpassing the expectation of investors. The first two REITs: CMT and A-REIT have grown by more than 200% over a period of three years since listing in 2002, despite their projected yields of 7% and 8% respectively at the IPO.

![Figure 1: Total Return Index of SREITs (as at July 2005)](image)

“*Are REITs stocks or real estate?*” This is a fundamental, but critical question that has significant impact on the portfolio decision of institutional investors, who are allocating a significant proportion of their investment into REITs. As we know, REIT is an equity vehicle created by pooling funds exclusively for investment in income-producing properties. Real estate must constitute at least 70% of the total asset value under the Singapore’s REIT guideline. Therefore, it is natural that REIT investors will have to look at trends and shocks in property markets when evaluating REIT price performance. On the other hand, REITs, being listed on the stock market, are more liquid and low in transaction costs. REIT prices are subject to stock market volatility, and stock market shocks can therefore not be neglected by investors.

In the US, study showed that historical return and risk characteristics of REITs in the 1980s were less like stocks, but more like real estate. In 1990s following several changes to the REITs legislations that grant more flexibility in REIT operations and

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structure, price behaviors of the post 1990s modern REIT stocks have become more stock-like. One implication for institutional investor is that they may expect their portfolio consisting of stock and REITs to be less effective in terms of risk diversification.

In Singapore, historical risks and return of REIT stocks and their correlations with benchmark equity market and all-property indices are analyzed to determine whether S-REITs exhibit stock-like characteristics. Table 2 shows that risk-return characteristics of S-REITs clearly outperformed selected property counters that include CapitaLand, the sponsor of CMT and CCT, over the period of 2000 to 2004. S-REITs have superior returns ranging from 14.01% to 22.93%, and lower risks of 1.78% to 2.22% with the exception of CCT that showed a higher volatility of 4.29% because of the short listing history of less than 7-months as at December 2004. In term of correlation (Table 3), we do not see strong co-movement of the REIT price changes with the benchmark all-equity return and all-property return. Till the sample period of 2004, S-REITs did not exhibit close resemblance with all-equity and all-property. It implies that S-REITs do have risk-reduction effect on multi-asset portfolios of institutional investors.


<table>
<thead>
<tr>
<th>No</th>
<th>Asset Type</th>
<th>Code</th>
<th>Mean Weekly Return</th>
<th>Standard Deviation</th>
<th>Annualized Return</th>
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<tbody>
<tr>
<td>A) Selected Property Stocks</td>
<td>1</td>
<td>GUOCOLAND</td>
<td>RGUCL</td>
<td>0.08%</td>
<td>5.41%</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>CITY DEVELOPMENTS</td>
<td>RCITY</td>
<td>0.09%</td>
<td>5.29%</td>
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<tr>
<td></td>
<td>3</td>
<td>SINGAPORE LAND</td>
<td>RSLND</td>
<td>0.06%</td>
<td>2.49%</td>
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<tr>
<td></td>
<td>4</td>
<td>CAPITALAND</td>
<td>RCPTL</td>
<td>-0.01%</td>
<td>5.08%</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>WING TAI HOLDINGS</td>
<td>RWING</td>
<td>-0.05%</td>
<td>5.61%</td>
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<tr>
<td>B) REITs</td>
<td>6</td>
<td>FORTUNE REIT</td>
<td>RFORT</td>
<td>0.47%</td>
<td>2.17%</td>
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<tr>
<td></td>
<td>7</td>
<td>ASCENDAS REIT</td>
<td>RAREI</td>
<td>0.57%</td>
<td>2.22%</td>
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<td></td>
<td>8</td>
<td>CAPITACOMMERCIAL TRUST</td>
<td>RCCTO</td>
<td>0.35%</td>
<td>4.29%</td>
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<td></td>
<td>9</td>
<td>CAPITAMALL TRUST</td>
<td>RCMTR</td>
<td>0.44%</td>
<td>1.78%</td>
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<tr>
<td>C) Stock Index/ T-bills</td>
<td>10</td>
<td>SINGAPORE ALL-SHARE</td>
<td>RALLS</td>
<td>0.06%</td>
<td>2.52%</td>
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<tr>
<td></td>
<td>11</td>
<td>SINGAPORE ALL-PROPERTY</td>
<td>RALLP</td>
<td>0.01%</td>
<td>3.35%</td>
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<tr>
<td></td>
<td>12</td>
<td>3-MONTH T-BILL</td>
<td>A3TBL</td>
<td>0.51%</td>
<td>1.04%</td>
</tr>
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</table>

Table 3: Correlations between Returns of REITs and Benchmark Stock Indices

<table>
<thead>
<tr>
<th></th>
<th>RAREI</th>
<th>RCCTO</th>
<th>RCMTR</th>
<th>RFORT</th>
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<tbody>
<tr>
<td>RALLS</td>
<td>0.075</td>
<td>0.361</td>
<td>0.053</td>
<td>-0.167</td>
</tr>
<tr>
<td>RALLP</td>
<td>0.024</td>
<td>0.315</td>
<td>-0.008</td>
<td>0.001</td>
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</table>

Ownership and Management Structure of S-REITs

In the US, REITs must meet stringent ownership tests to mitigate potential conflict interests of sponsors and unitholders of REITs. REIT units must be distributed to at least 100 different shareholders, and 50% of the REIT units can not be concentrated in 5 major shareholders (known as 5/50 rule). Ownership restrictions are also imposed on Japanese REITs (J-REITs): the largest three J-REIT unitholders must not own more than 50% of the J-REIT units, and the largest ten unitholders must not own more than 75% of J-REIT units, and J-REIT units must be distributed to at least 1000 investors.

In Singapore, REIT sponsors retained substantial control of S-REIT shares after IPOs (Table 3), and an independent asset management subsidiary is also set up by sponsors to render fee-based management services to REITs (Table 1). These REITs are known as captive REITs. In the US, the close relationship between sponsors and management companies in captive REITs creates potential sources of agency problems, which include over-paying properties unloaded by sponsors. Given the high agency costs associated with captive REITs, they were found to have significantly underperformed non-captive REITs.

In Singapore, regulatory restraints and market mechanisms have been in place to instill financial discipline and mitigate potential conflict of interests in S-REITs. Such market and regulatory mechanisms include independent boards of directors, prudent and yield-accretive acquisition strategies, 35% borrowing cap, independent valuation, and disclosure of self-dealing with sponsors. The controlling stake of sponsors in S-REITs itself can be construed as a positive signal on the part of sponsors to act in good faith so as to preserve their reputation, and at the same time, minimize their financial risks in S-REITs. The influence of institutional investors via large holdings of S-REITs units will also serve as an effective monitoring on REIT managers’ performance.

S-REITs adopt an externally managed/advised model, where a third party asset manager is appointed to provide professional asset management service. The model is prevalent for Australia’s Listed Property Trusts (LPT) and many US REITs listed in 1970s and 80s. The Tax Reform Act in 1986 in the US facilitates the creation of more internally managed REITs in the 1990s that are less susceptible to agency problems. Empirical evidence in the US showed that externally advised REITs consistently used more debt than internally advised REITs, which caused the under-performance of externally advised REITs. In Australia, stapling of LPT and sponsors/parent companies has become a popular mean of internalizing the management structure of LPTs.

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3 The Omnibus Budge Reconciliation Act (OBRA) of 1993 allows REIT to “look-through” institutional funds as collections of individual beneficiaries/investors, which effectively nullifies the 5/50 and 100-shareholder constraints.


5 As at 1 March 2005, the top 10 largest institutional investors (excluding deemed interests of the sponsor) constitute about 47.84% of the total CMT units floated.

Externally managed structure is more prone to agency problem. For a third party manager that manages multiple REITs, it will be more pressing to maintain a high level of transparency and independency. Examples of potential agency conflicts that are detrimental to long-term value of REITs include collusion between a trust manager and a vendor in a sell and leaseback arrangement that deliberately inflates asset prices and lease-back rents. Ms Ho Ching, the executive director and CEO of Temasek Holdings, in a dinner marking the successful listing of Mapletree Logistic Trust\(^7\) cautions that “irresponsible” and “incompetent” trust managers could be a source of management risks for REIT investors. The Monetary Authority of Singapore (MAS) has undertaken a review of regulatory framework on REITs in June 2005 that aims to strengthen oversight of REIT managers, and improve corporate governance practice and alignment of interests between REIT manager and unitholders. The new guidelines may include licensing of REIT managers, more disclosure of acquisition and divestment fees payable to REIT managers, and obtaining two independent valuations in the acquisition of properties from interested party.

**Growing S-REITs via Yield Accretive Acquisitions**

Today, S-REITs have reached a market capitalization of S$10.62 billion over a short period of 3 years since the first listing of CMT in 2002 (Figure 2). This figure does not include the recent proposed acquisitions such as Parco Bugis Junction and Jurong Entertainment Center by CMT, and also 9 industrial properties including Techview, Techquest, Logishub@Clementi, Hoya Building and others that are worth S$271.7million by A-REIT. With a combination of secondary equity raising and debt financing, the market sizes of CMT and AREIT have soured to $3billion as in July 2005, which make them the third and fourth largest capitalized stocks after City Developments and CapitaLand, when ranked side-by-side with other property stocks on Singapore Exchange.

![Figure 2: Market Capitalization of S-REITs](image-url)

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The aggressive acquisition strategies will continue to propel S-REITs growth following the comments made by the CEOs of the two largest S-REITs:

“A lot of people are concerned that CMT doesn't have growth potential in Singapore. I want to dispel that. We strongly believe that growing our asset size to $4-5 billion in three years (from $2.2 billion currently) through acquisitions in Singapore alone can be achieved.”

**Pua Seck Guan**, CEO of CapitaMall Trust Management Ltd (CMTML)

“There is a lot more room for A-Reit to grow, with the trust aiming to expand to $3-4 billion in time to come. There are about 20-25 million sq m in the investible universe for A-Reit out of some 26.4 million sq m of business space in Singapore.”

**Tan Ser Ping**, CEO of A-Reit manager Ascendas-MGM Funds Management.

Stamp duty remission up to a period of 5 years on properties sold to REITs is an added incentive announced in the recent 2005 Budget that will enhance competitiveness of REITs in their acquisition drives. If the stamp duty savings of nearly 3% of sale price were shared and/or reverted back to property owners, it would help sweeten prices offered by REITs assuming that investment yields remain unchanged. This will have significant impact on the price discovery process in commercial and industry property market. On the other hand, professional valuers will face more uncertainty and are required to exercise more judgment in differentiating open market values from investment values.

The stamp duty waiver coupled with tax transparency make REITs a more efficient vehicle vis-à-vis other less efficient tax corporate vehicles in holding real estate assets. Will more real estate listed companies and banks with substantial holdings divest real estate through REITs in the near future? The expected rate of returns for divesting real estate assets will likely be one of the key economic considerations of firms that are in the fringe of putting their assets into REITs.

“Does size matter for REITs?” In attempts to grow REITs, managers will also have to sit back and think of how to capitalize economic benefits associated with enlarged REIT portfolios. Positive economic of scale effects can be achieved by larger asset size in terms of management economies of scale, lower cost of capital, branding image, increasing bargaining power with customers and suppliers. However, size efficiency may also diminish when the span of control of a REIT is exceeded. Therefore, it would be important to make sure new acquisitions will not only yield-accrete but also provide integration and synergies to the portfolios.

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10 Open market value is a concept involves arm-length transaction at price determined in the presence of willing buyer and willing seller after taking into consideration the supply and demand conditions in the market. It is different from investment value that will take into account the special tax concessions like the stamp duty waiver for REITs.
Challenges Ahead

REITs have no doubt made significant impact in Singapore over a short period of 3 years. Compared to the mature US REIT and Australian LPT markets, there are more challenges ahead for various parties in the REIT market: sponsors, trust and asset managers, professional valuers and financial advisors, investors, stock exchange and regulator. While it is important to continue to strengthen the governance and operation structure in Singapore REIT market, the government also strives to turn Singapore into a regional REIT hub, which will give regional REITs a direct and ready access to capital. The regulator has been urged to make cross-border REITs in Singapore more attractive:

“It would be an interesting challenge to see if Singapore can be a hub for another 30 to 50 of the top quality Asian REITs over the next 10 to 20 years.”

- Ms Ho Ching, the Chief Executive, Temasek Holdings

A REIT hub could also be a place where knowledge and expertise in REIT could be outsourced to REITs from other markets. The appointment of CapitaLand as a strategic partner of the Link REIT management, the first and the largest REIT IPO due to be re-launched in Hong Kong after clearing the legal obstacles, is an important recognition of the REIT expertise of Singapore companies.

Competition will likely to get more intense over the next few years as other regional markets are actively gearing up to pave ways for REIT listings in their respective bourses. Japan is clearly the leader in Asia REIT markets in terms of its current market capitalization and the number of J-REIT listing. Several new REITs have also obtained listing approval in Malaysia, such as Axis REIT and YTL REITs. Hong Kong Housing Authority is also in the process of getting ready to launch again the largest REIT IPO on Hong Kong Stock Exchange.

REITs are a global instrument, but real estate assets are local in nature. The game of REIT will depend on the cost efficiency of listing on different markets. Clearly, the playing fields are now more level considering various tax incentives and waivers granted by various governments to entice REIT listing on their respective markets. While Singapore may not dominate the REIT game by attracting all regional REITs to list on Singapore market, the government could, however, provide incentives and supports to encourage more Singapore companies to establish cross-border REITs holding overseas properties on other bourses as a strategy to expand their portfolios.

End.

Date: 2 August 2005

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<table>
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<tr>
<th>Listed Real Estate Investment Trust</th>
<th>Sponsoring Developer</th>
<th>REIT Manager</th>
<th>Date of Listing</th>
<th>Initial Public Offering (IPO) Size</th>
<th>Aggregate Appraised Asset Value @ IPO</th>
<th>Market Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>CapitaMall Trust</td>
<td>CapitaLand</td>
<td>CapitaMall Trust Management Ltd</td>
<td>21-Jul-2002</td>
<td>S$235.2 million / US$141.6 million</td>
<td>S$895 million</td>
<td>Retail</td>
</tr>
<tr>
<td>Fortune ReIT</td>
<td>Cheung Kong (Holdings)</td>
<td>ARA Asset Management (Singapore) Ltd</td>
<td>12-Aug-2003</td>
<td>S$193.6 million / HK$906.0 million</td>
<td>S$740.9 million (HK$3275 million)</td>
<td>Retail (Hong Kong)</td>
</tr>
<tr>
<td>CapitaCommercial Trust</td>
<td>CapitaLand</td>
<td>CapitaCommercial Trust Management Ltd</td>
<td>17-May-2004</td>
<td>S$1459.8 million / US$878.8 million</td>
<td>S$2,018.5 million</td>
<td>Mixed commercial property (office, carparks and retail)</td>
</tr>
<tr>
<td>SuntecREIT</td>
<td>Suntec City Development Ltd</td>
<td>ARA Trust Management (Suntec) Ltd</td>
<td>9-Dec-2004</td>
<td>S$722.0 million / US$434.6 million</td>
<td>S$2,150 million</td>
<td>Mixed commercial property</td>
</tr>
<tr>
<td>Mapletree Logistic REIT</td>
<td>Mapletree Investment Ltd</td>
<td>Mapletree Logistics Trust Management Ltd</td>
<td>28-Jul-2005</td>
<td>S$211.0 million / US$127.0 million</td>
<td>S$422 million</td>
<td>Logistic</td>
</tr>
</tbody>
</table>

# Currency conversion (29 July 2005): S$1: HK$0.2137 and S$1: US$0.602

Sources: IPO Prospectus of the respective S-REITs compiled by Author