

Asia-Pacific REITs

Building Trust through
Better REIT Governance



©2011 CFA Institute

CFA Institute, with more than 100,000 members worldwide, is the not-for-profit professional organization that awards the Chartered Financial Analyst® (CFA®) and Certificate in Investment Performance Measurement (CIPM®) designations.

The CFA Institute mission is to lead the investment profession globally by setting the highest standards of ethics, education, and professional excellence. In advancing our mission, we strive to be a leading voice on issues of fairness, efficiency, and investor protection in the global capital markets.

ISBN 978-1-934667-35-4
February 2011

Asia-Pacific REITs

**Building Trust through
Better REIT Governance**



Contents

| | |
|--|----|
| Section 1: Summary and Recommendations | 1 |
| Recommendations for Existing REIT Structures | 1 |
| Recommendations for an Ideal REIT Governance Structure | 3 |
| Section 2: The Asia-Pacific REIT Market | 5 |
| What Exactly Is a REIT? | 5 |
| The Global REIT Market | 6 |
| The Asia-Pacific REIT Market | 7 |
| Section 3: Individual REIT Markets | 10 |
| Australia | 10 |
| Japan | 15 |
| Singapore | 18 |
| Hong Kong | 22 |
| The Philippines | 26 |
| India | 29 |
| China | 30 |
| Section 4: Cases | 32 |
| Centro Properties Group and Centro Retail Trust | 32 |
| MI-REIT Recapitalization and CIT Attempted Merger | 34 |
| Lend Lease US Office Trust | 39 |
| Fortune REIT | 40 |
| FC Residential Investment Corporation | 42 |
| Mori Hills REIT | 44 |
| Section 5: Recommendations for Existing REIT Structures | 47 |
| Board Independence of the REIT Manager | 47 |
| Annual General Meetings (AGMs) | 49 |
| Ownership Structure and Related-Party Transactions (RPTs) | 50 |
| Manager Entrenchment | 52 |
| Removing the REIT Manager | 53 |
| Management Fee Structure | 54 |
| Gearing Restrictions | 56 |
| REIT Governance | 57 |
| Section 6: Recommendations for an Ideal REIT Governance Structure | 59 |
| Characteristics of an Ideal REIT Governance Structure | 59 |
| Appendix A. REIT Codes and Regulations | 61 |
| Appendix B. Profiles of Selected REITs | 66 |
| Appendix C. Sources and Resources | 75 |

A note on the use of this report:

Case citations. The actual cases describing the practices of REITs were gathered from company announcements on the stock exchanges and company websites, published reports in major English-language newspapers and on websites, and securities commission websites. Each case source is attributed in the footnotes; we have not contacted the companies involved in these cases.

Acknowledgments. CFA Institute thanks the individuals and institutions that participated in this report and respects their request to remain anonymous.

Section 1: Summary and Recommendations

Real estate investment trusts (REITs) are investment vehicles that invest in a diversified pool of professionally managed real estate assets. The relatively passive investments and the steady rental stream are among the many characteristics that make them attractive investments. They also typically have a high tax-effective yield, provide an avenue for investors to invest in real estate without the large capital outlay and risk, and provide diversification to an equity portfolio. Unfortunately, sometimes these positive characteristics are clouded by REIT governance issues that can weaken unitholders' rights.

REITs in Asia Pacific are predominantly externally managed by a REIT manager. The manager is paid a fee by the REIT in return for its management services. The manager has a fiduciary duty to act in the best interests of unitholders; however, the separation of ownership and control has the potential to create conflicts of interest between unitholders (principals) and managers (agents).

In the case of REITs in Asia Pacific, the REIT sponsor plays an important role because it is the entity that sources the properties that are initially placed into the REIT at the time of listing. More importantly, it usually wholly owns the REIT manager, and to further confuse matters, the sponsor often also holds a large unitholding in the REIT. This interrelatedness increases the risk that the manager/sponsor will act in its own interest at the expense of minority unitholders, thereby exacerbating the principal-agent conflict. Many of the REIT governance issues identified in this report arise because of these conflicts of interest.

Conflicts arising from the principal-agent relationship can be managed if proper investor protection measures are in place that limit the ability of managers to expropriate the rights of unitholders. Because of their different structure, REITs are usually governed by REIT codes or various legislation that is separate from corporation legislation. Consequently, they are often not afforded the same rights. For this reason, it is important for REITs to have a robust governance structure in place to minimize the risk of expropriation by insiders and to strengthen unitholders' rights.

The Asia-Pacific REIT market is the second largest REIT market globally, representing about 21 percent of the total global REIT-market capitalization. North America is the largest REIT market, accounting for 60 percent. Within the Asia-Pacific region, Australia is the largest and oldest market, accounting for approximately 58 percent of the region, followed by Japan with 20 percent, Singapore, with 14 percent, and Hong Kong with 8 percent.¹ Significant potential for growth exists in this region if China and India follow through with their plans to introduce REITs into their markets. The Philippines is currently in the process of finalizing its REIT legislation and hopes to have its first REIT listed in 2011.

This report focuses on the four largest REIT markets in Asia Pacific—Australia, Japan, Singapore, and Hong Kong—and is intended to be a resource for regulators and industry participants. The objective is to provide a guide on effective governance structures for regulators and industry participants in new or prospective REIT markets and help regulators in existing REIT markets improve their current REIT governance standards with the ultimate goal to improve unitholder protection.

Recommendations for Existing REIT Structures

Recommendations one through eight provide practical and straightforward ways to improve current governance practices in the near-term in externally managed REITs.

1. Board Independence of the REIT Manager

Recommendation: Governance requirements for the REIT manager's board of directors should be included in the licensing requirements for managers. The board's role should be to provide independent review and oversight over the REIT manager and the operations of the REIT.

- The REIT manager's board of directors should be majority independent, where the definition of independence excludes management, sponsors, and substantial unitholders.

¹All statistics are from FTSE EPRA/NAREIT Developed REIT Index, October 2010. NAREIT is the National Association of Real Estate Investment Trusts.

- The role of the chairman should not only be separate from that of the CEO but also independent of management, sponsors, and substantial unitholders.
- Cross directorships that have the potential to cause a conflict of interest should not be permitted.

2. Annual General Meetings

Recommendation: Annual general meetings (AGMs) should be mandatory for all REITs.

The board and management team of the REIT manager and the trustee should be present at the AGM. Unitholders need to have the right to meet the people managing their investments and question their decisions to ensure that managers are managing the REIT in their best interests. An annual meeting increases the manager's accountability to unitholders and provides an opportunity to update investors on the performance and strategy of the REIT.

3. Ownership Structure and Related-Party Transactions

Recommendation: The identities and level of ownership of related parties who have substantial unitholdings should be disclosed, and material related-party transactions (RPTs) should be reviewed by independent experts, disclosed to the local stock exchange, and approved by independent directors and independent unitholders.

As best practice, all REITs (including the REIT manager) should adopt a written "Conflict of Interest and Related-Party Transactions Policy" wherein they define "related party," express why they may need to engage with related parties, and outline their internal-control procedures in dealing with conflict-of-interest situations and RPTs.

RPTs (that reach the approval and disclosure thresholds) should be:

1. Reviewed by an independent adviser to ensure that only fair-market valuations are applied;
2. Approved by "disinterested" directors when board approval is required;
3. Disclosed to investors in a timely manner through an announcement to the local stock exchange; and
4. Approved (if material) by unitholders in a vote by poll with related parties abstaining from the vote.

4. Manager Entrenchment

Recommendation: Trust deeds/management agreements should not contain clauses that in any way entrench the manager or limit unitholders' rights.

If any such clause is included in the IPO, it must be clearly disclosed in the offer document. If introduced after listing, any such clause must be subject to unitholder approval. This approach will allow the market for corporate control to function effectively and unitholders' rights will not be compromised because they will have the ability to exercise their right to vote out management.

5. Removing the REIT Manager

Recommendation: Unitholders should have the right to remove and appoint the REIT manager.

They should also have the right to call a meeting, put forward a resolution to remove/appoint the manager, and participate in a fair vote on an ordinary resolution to remove or elect a manager.

6. Management Fee Structure

Recommendation: A fee structure needs to be established that aligns the interests of unitholders with those of the manager.

Performance fees should be structured so that managers are rewarded for good performance and penalized for poor performance. Making fees contingent on actual performance, such as relative share price performance or distribution per unit (DPU), will better align interests and decrease potential agency problems.

7. Gearing Restrictions

Recommendation: No need exists for leverage restrictions in regulations as long as proper governance practices are in place and the rights of unitholders are not compromised.

Decisions to use debt funding should remain business decisions. To improve transparency, REITs should provide adequate disclosure of relevant information about debt covenants and debt restrictions imposed in their trust deeds.

8. REIT Governance

Recommendation: Given the trust structure of REITs in Hong Kong, Singapore, and Australia, the best governance structure to minimize conflicts of interest between managers and unitholders and improve oversight is the single responsible entity.

Under this structure, only one responsible entity is accountable to investors. The single responsible entity is responsible for holding the assets in custody for unitholders and for the independent oversight of the REIT. Confusion around the roles and responsibilities of trustees is removed and replaced with independent boards and/or independent compliance committees.

Recommendations for an Ideal REIT Governance Structure

The following recommendations describe the governance characteristics of an ideal REIT structure. The structure incorporates many of the earlier recommendations and aims to facilitate growth in new and prospective REIT markets as well as to help guide long-term changes in existing markets.

1. Internalized Management

Recommendation: An internal management structure better aligns the interests of the manager with those of the unitholders.

- When the REIT wholly owns the manager, so that the employees of the manager are now employees of the REIT, conflicts of interest between unitholders and the manager are reduced.
- The management team is independent from the REIT sponsor.
- A trust structure cannot have any employees, so an internalized management structure suggests the corporate structure is most appropriate. This structure is only feasible for REITs if a tax-exempt corporate structure is possible under the various tax laws.²

2. Board of Directors

Recommendation: A REIT should have its own independent board of directors, and unitholders should be able to appoint or remove directors.

- The board should oversee management and review all major financial decisions. It would monitor the performance of the manager and ensure the manager is carrying out its duties in the best interests of unitholders.
- The board should consist of majority independent directors and an independent chairman.
- Unitholders should have the right to nominate, appoint, and remove directors. The thresholds for approval should not be overly burdensome to try to restrict unitholders' voting rights.

3. Annual General Meetings

Recommendation: Annual general meetings (AGMs) should be mandatory for all REITs.

Unitholders need to have the right to meet the people managing their investments and question their decisions to ensure that they are managing the REIT in the unitholders' best interests. An annual meeting increases management's accountability to unitholders and provides an opportunity to update investors on the performance and strategy of the REIT.

4. Approvals for Related-Party Transactions

Recommendation: Material related-party transactions (RPTs) should be reviewed by independent experts, disclosed to the local stock exchange, and approved by independent directors and independent unitholders.

²Discussion of tax effective structures is beyond the scope of this report.

As best practice, REITs should adopt a written “Conflict of Interest and Related-Party Transactions Policy” wherein they define “related party,” express why they may need to engage with related parties, and outline their internal-control procedures for dealing with conflict-of-interest situations and RPTs.

RPTs (that reach the approval and disclosure thresholds) should be:

1. Reviewed by an independent adviser, to ensure that only fair-market valuations are applied;
2. Approved by “disinterested” directors when board approval is required;
3. Disclosed to investors in a timely manner through an announcement to the local stock exchange; and
4. Approved (if material) by unitholders in a vote by poll with related parties abstaining from the vote.

5. Remuneration

Recommendation: In an internally managed structure, the management team should receive salaries, making managers’ fees irrelevant.

It is important to have a remuneration committee with a minimum of three directors, a majority of whom are independent. This committee will help ensure that management is paid salaries and incentives that are commensurate with their responsibilities and performance. Remuneration policies and a detailed remuneration report should also be disclosed to investors.

6. Gearing Restrictions

Recommendation: No regulatory need exists for leverage restrictions as long as proper governance practices are in place and the rights of unitholders are not compromised.

The decision to use debt funding should be a business decision. Increased disclosure about debt covenants and debt restrictions imposed in the trust deed will facilitate transparency and improve investor protection.

7. Controlling Unitholders Should Not Own More Than 50 Percent of the Issued Units

Recommendation: A unitholding restriction of 50 percent would not only improve REIT governance practices but also improve tax pass-through benefits for investors.

A public float of at least 50 percent can help eliminate potential conflicts of interest between the controlling unitholder and other investors. It provides unitholders with the opportunity to exercise their rights without being marginalized by a controlling unitholder. It also would allow a greater number of investors to benefit from the tax benefits of owning a REIT. When the REIT is closely held by the sponsor, the REIT essentially acts as a subsidiary of the sponsor. Consequently, the sponsor is able to keep a majority of the tax incentives available to investors.

Section 2: The Asia-Pacific REIT Market

What Exactly Is a REIT?

In Asia Pacific, real estate investment trusts are typically collective investment vehicles that invest in a diversified pool of professionally managed real estate assets. REITs provide investors greater diversification and liquidity with a smaller capital outlay than they would achieve if they invested directly in the property market. The underlying assets provide capital growth, and the steady rental stream provides investors with income via regular distributions.

The main features of a REIT include:

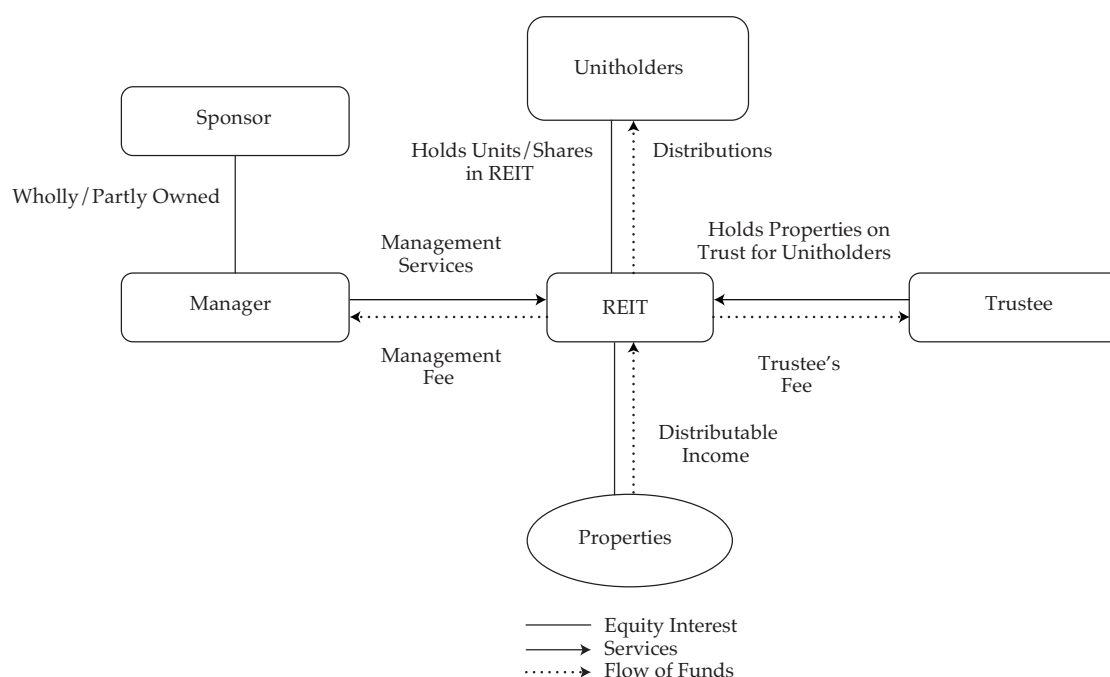
- An investment in a diversified pool of income producing real estate assets
- Typically structured as a unit trust (or corporation) and are listed and traded on a stock exchange
- Externally or internally managed
- Flow-through taxation
- High yield

The three main benefits of REITs are:

- **Flow-through taxation.** As long as the REIT meets certain requirements under the various tax laws, investors can benefit from “flow-through” taxation, in which the REIT is not taxed on its income and tax is paid only once in the hands of investors.
- **Greater liquidity and capital flexibility.** Investors are able to get exposure to the capital growth and income stream of the underlying assets without large capital outlay. It also allows investors to benefit from greater liquidity as compared with investing in the real underlying assets.
- **High yield.** Typically, the main attraction of REITs is their yield. REITs usually have high payout ratios that are either mandated in REIT codes or are incentivized by taxation requirements.

Figure 1 shows a typical externally managed REIT structure.

Figure 1. Typical Externally Managed REIT Structure



Trustee. Under the trust deed, the trustee is responsible for holding the properties in trust for unitholders. It must exercise due diligence in protecting the rights and interests of unitholders. The trustee's duty is to oversee the functioning of the management company and ensure it is performing in line with the trust deed and relevant laws. The trustee, typically a bank or its subsidiary, is paid a fee based on a percentage of the REIT's underlying asset value.

The trust deed is the agreement between the manager and the trustee that governs the way the REIT is legally organized and managed. It describes the duties and responsibilities of the manager and the trustee, as well as the rights and interests of unitholders.

Manager. REITs can either be externally or internally managed. With the exception of Australia, most REITs in Asia Pacific are externally managed.

External management. The external management structure is the most traditional. The trust's assets are managed by an external manager that carries out all the management duties, such as operations, financing, and property management. Investors buy units in the trust, and the units trade independent of the manager, who may or may not be a listed company.

In exchange for services, the manager charges a management fee that can include a base fee and a performance fee that is typically based on net income, net assets, or relative share price of the trust. It may also charge the trust such additional fees as acquisition/disposal fees and property management fees if the service is not outsourced to another company.

Internal management. In an internally managed REIT, the trust owns the assets and the management company. An example is The Link REIT listed in Hong Kong. Under this structure, unitholders own units in the REIT, which wholly owns the manager, and the separate functions of the trustee and the manager remain the same.

Another example of internal management is stapled securities. In these internally managed REITs, the management duties are carried out by an internal management company that is "stapled" to the trust. This structure gives investors one unit in the trust and one share in the management company, which are effectively stapled and traded together on the exchange. Stapled securities are popular in Australia (see Section 3 for more detail on internal management and stapling).

Sponsor. Although not normally a featured party in such diagrams as Figure 1, the REIT sponsor plays an important role in the Asia-Pacific REIT market. The sponsor is the entity that sources the properties that are initially placed into the REIT at the time of listing. The sponsor is typically a participant in the real estate industry, for example (but not limited to), (1) an owner of properties, (2) a property developer, (3) a fund manager, or (4) an operating business with an investment in property.

Typically the motivation to divest properties into a REIT is to recycle capital and raise funds. Although the REIT is a completely separate listed entity, the sponsor is often still very connected to the operations and cash flow of the REIT. It is very common for the manager and the property manager to be wholly owned subsidiaries of the sponsor. Therefore, the sponsor captures the entire fee stream paid by the REIT to the manager. The sponsor can also have large unitholdings in the REIT, which not only allows it to retain interest in the underlying cash flows of the properties but also gives it significant control.

The Global REIT Market

The U.S. REIT market is both the largest and the oldest market globally, dating back to 1961 when the first REIT was listed on a U.S. stock market. As **Figure 2** shows, the Netherlands in Europe was next to establish a REIT market in 1969, followed by Australia in 1971. The global REIT market has experienced significant growth in the past 20 years, with an additional 20 countries adopting REIT legislation or an equivalent. In 2010 several other countries, including India and China, were considering setting up REIT markets, as was the Philippines, which had legislation in place but was waiting for final governmental approvals before the REITs could officially list and function.

Figure 2. Evolution of the Global REIT Market

| 1960 | 1970 | 1980 | 1990 | 2000 | 2010 | Future |
|-------------|-----------|------|-------------|--------------|------|-----------------|
| USA | Australia | | Canada | Japan | | The Philippines |
| Netherlands | | | Belgium | South Korea | | India |
| | | | Turkey | Singapore | | China |
| | | | New Zealand | South Africa | | Mexico |
| | | | | France | | |
| | | | | Greece | | |
| | | | | Taiwan | | |
| | | | | Brazil | | |
| | | | | Thailand | | |
| | | | | Hong Kong | | |
| | | | | Bulgaria | | |
| | | | | Malaysia | | |
| | | | | Israel | | |
| | | | | Germany | | |
| | | | | UK | | |
| | | | | Italy | | |

Source: The Association for Real Estate Securitisation and CFA Institute

The Asia-Pacific REIT Market

The REIT market in Asia Pacific is the second largest globally,³ worth approximately US\$118 billion and accounts for 21 percent of the total REIT market capitalization.⁴ **Figure 3** illustrates the breakdown by region. North America is the largest market, comprising circa 60 percent of the global market. As of 29 October 2010, the North American REIT market was worth approximately US\$332 billion with the United States comprising 92 percent (or US\$306 billion) of the total and Canada the remainder. Europe is not far behind Asia Pacific, worth US\$107 billion, or 19 percent of the global market total.

With the exception of Australia, the Asia-Pacific REIT market is relatively young. Australia comprises approximately 58 percent of the market in the region with a market capitalization of US\$68 billion and 55 REITs listed.⁵ Globally, Australia is the second largest market after the United States. The Japanese REIT market is the next oldest and largest, with 36 listed REITs worth circa US\$24 billion, or 20 percent of the total market in Asia Pacific.⁶ Singapore and Hong Kong follow with approximately US\$16 billion (21 listed REITs⁷) and US\$10 billion (7 listed

³All data in this section are from the FTSE EPRA/NAREIT Developed REIT Index, produced by FTSE International in association with European Public Real Estate Association and National Association of Real Estate Investment Trusts. The index is a subset of the FTSE EPRA/NAREIT Global Real Estate Series that launched in February 2005. The FTSE EPRA/NAREIT Developed REITs and Non-REITs Indices enable investors to differentiate REIT from Non-REIT constituents within the EPRA/NAREIT universe according to country-specific REIT legislation. The index does not cover all listed REITs in all jurisdictions with REIT legislation because the securities need to meet certain eligibility criteria before they are included in the index. For more information on the FTSE EPRA/NAREIT REIT Indices, please refer to www.ftse.com/Indices/FTSE_EPRA_NAREIT_Global_Real_Estate_Index_Series/index.jsp.

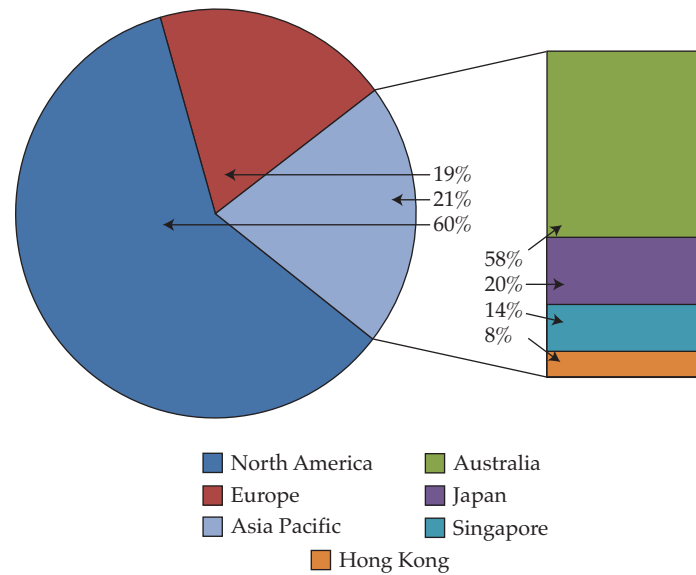
⁴To assist in comparisons between the markets, our analysis is in U.S. dollars. The relevant EUR/USD exchange rate of \$1.39 on 29 October 2010 was used.

⁵Excludes Westfield Retail Trust, which was listed on the ASX in December 2010.

⁶As of December 2010, there are 35 listed J-REITs after a merger in early December.

⁷Includes Fortune REIT, which has a dual listing in Singapore and Hong Kong. Excludes Sabana REIT, which was listed on the Singapore Exchange on 26 November 2010.

Figure 3. Global REIT-Market Capitalization, as of 29 October 2010



Source: Data from FTSE EPRA/NAREIT Developed REIT Index.

REITs⁸), respectively. REITs are also established in other markets in Asia Pacific, such as New Zealand, South Korea, Thailand, Taiwan, and Malaysia. They represent, however, less than 1 percent of the REIT market in Asia Pacific and less than 0.5 percent globally.

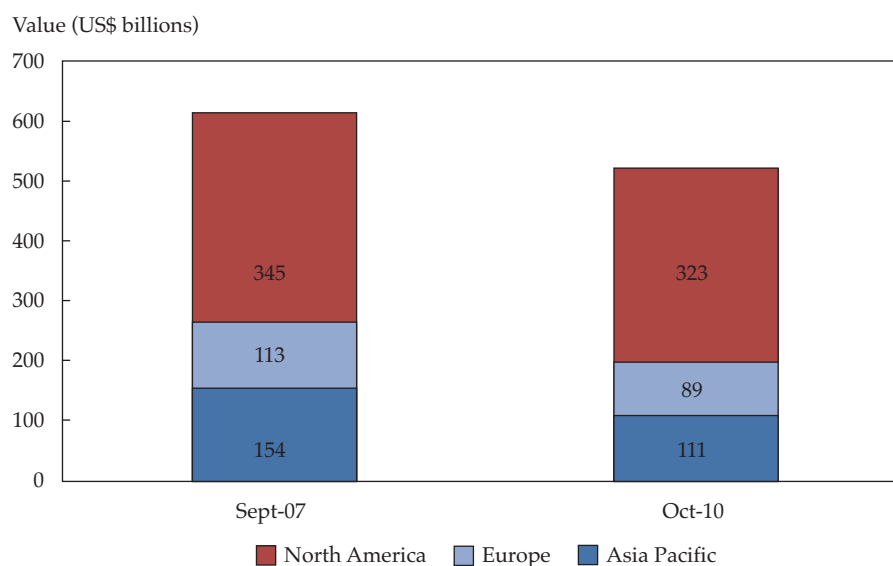
Like the rest of the capital markets, REITs suffered large market revaluations through the global downturn. From the peak in September 2007, the global REIT market has lost about 15 percent in value. The capital intensive nature of REITs and their reliance on debt financing made them particularly exposed when the credit markets imploded. A combination of high gearing and falling asset values left many REITs with ballooning loan-to-value (LTV) ratios and banks knocking on their door because they were in breach of debt covenants. Renegotiating debt terms was difficult because of the lack of liquidity and inflated prices. Subsequently, REITs were under significant pressure and were one of the first asset classes to tumble.

As seen in **Figure 4**, although all markets suffered huge losses, nearly 30 percent of the value in the Asia-Pacific REIT market was destroyed between September 2007 and October 2010. On closer examination, however, Asia Pacific was heavily influenced by the significant drop in market capitalization in Australia and Japan. Excluding the negative impact of Australia and Japan from Asia Pacific, the region has in fact increased in value by 38 percent since September 2007.

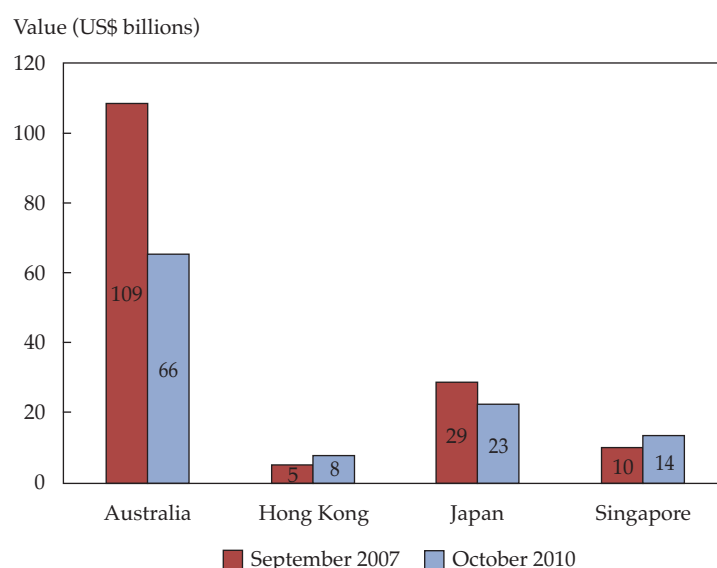
The breakdown among the Asia-Pacific countries is illustrated in **Figure 5**. Australia was hardest hit by the downturn, with market capitalization in October 2010 down 40 percent from its peak in September 2007. The Australian REIT (A-REIT) market is the most sophisticated market in the Asia-Pacific region and was probably the most susceptible to a market downturn because it had moved away from the traditional, passive REIT model to riskier revenue streams, such as funds management and increased offshore business. The performance of the Japanese REIT (J-REIT) market was not as bad as Australia, although it was down 22 percent from September 2007. The continuing poor economic conditions in Japan contributed to the REIT market's underperformance.

In contrast, the REIT markets of Hong Kong and Singapore managed to achieve positive growth over the same time period. Hong Kong increased 49 percent, to US\$8.2 billion, and Singapore increased 35 percent, to US\$13.6 billion. The REIT structure in these two markets is more closely aligned to the traditional REIT model and so is perceived as lower in risk. REITs in these markets are also more highly regulated; for example, both Hong Kong and Singapore have gearing restrictions that are not present in either Australia or Japan.

⁸Includes Fortune REIT, which has a dual listing in Singapore and Hong Kong, and excludes RREEF China Commercial Trust, which is suspended pending delisting.

Figure 4. The Shrinking Global REIT Market


Source: Data from FTSE EPRA/NAREIT Developed REIT Index.

Figure 5. Asia-Pacific REITs through the Downturn


Source: Data from FTSE EPRA/NAREIT Developed REIT Index.

Since mid-2009, the REIT market in Asia Pacific has started to pick up steam. REITs in Australia, Hong Kong, and Singapore have been able to renegotiate debt funding, and many, especially in Australia, have recapitalized their balance sheets. Stronger balance sheets and improving credit conditions will put REITs in a good position to benefit from growth opportunities in the future. Given the weak economic conditions in Japan, J-REITs have found it difficult to recapitalize and refinance their debt, although the government has stepped in to support the market.

The number of new IPOs has been very low since the downturn, with many markets experiencing market consolidation rather than growth. In Japan, several REITs have merged and delisted, and the total number of J-REITs has decreased from 42 in June 2008 to 36 in October 2010, with no new listings since 2007.⁹ After a significant number of IPOs between June 2007 and June 2008, the number of REITs in Australia has also consolidated, with the total number in October 2010 on par with that from three years ago. Hong Kong has remained fairly stable, in contrast to Singapore where four REITs have listed since June 2008, including three in 2010.

⁹The number of listed J-REITs is 35 since the merger of Nippon Commercial Investment Corporation with United Urban Investment Corporation in December 2010.

Section 3: Individual REIT Markets

This section provides a comprehensive review of the four largest REIT markets in Asia Pacific: Australia, Japan, Singapore, and Hong Kong. It also provides a summary of the current status of prospective REIT markets in the Philippines, India, and China.

The focus of this section is on key regulatory requirements for REITs in terms of structure and governance practices. Please see Appendix A for the operational rules and requirements (such as percentage of real estate assets, taxation requirements, and allowable investments) as covered in legislation or in listing rules.

Australia

Background. The Australian listed REIT (A-REIT) market was established in 1971 with the listing of General Property Trust (GPT). Since its humble beginning, the market has grown to be the second largest REIT market globally, with a market capitalization of US\$68 billion in October 2010, behind only the U.S. market.¹⁰ Formerly known as listed property trusts (LPTs), the market initially struggled to gain popularity because of investors' limited understanding of the products and the benefits REITs offered. After the property market crash in the early 1990s, however, investors' preferences gravitated toward the listed property market because it offered greater liquidity, diversification, and yield.

The A-REIT market is supported by the compulsory superannuation scheme in Australia. Introduced in 1992, employers were initially required to contribute 3 percent of an employee's salary to superannuation. Mandatory employer contributions are now 9 percent of an employee's salary, and in June 2010, total super assets were A\$1.2 trillion, representing growth of 14.1 percent from June 2009.¹¹ A large proportion of these assets flow through to the listed stock market, so continued strong superannuation asset growth will further strengthen the A-REIT market in the future.

Several trends in the A-REIT sector can be observed since the early 1990s.

New listings throughout the 1990s. Until the late 1980s, the REIT sector in Australia was fairly small. It was not until the property crash in the early 1990s when investors began to demand more liquidity and risk diversification and the REIT sector began to take off as an asset class. This time was when sector-specific trusts were born. Several REITs listed with specific exposure to retail, commercial, industrial, and hotel assets. At its peak in 1999, there were more than 60 trusts listed on the Australian Securities Exchange (ASX). It was during this time that A-REITs began to expand their portfolios to include offshore exposures as a result of limited investment opportunities in Australia.

Consolidation in the early 2000s. Merger and acquisition activity in the sector was in full force around 2003–2004, with several large mergers, including the mergers of the three Westfield entities. The main trend was for larger trusts to absorb smaller REITs that were struggling to grow. Through consolidation, the number of REITs dropped to around 35 in 2004. It is thought that the merger of the Westfield group in 2004 was a “major catalyst for structural change in the Australian listed property trust asset class.”¹² The consolidation in the sector made room for new market entrants thus expanding the array of REITs available to investors.

Management internalization in mid-2000s. Since 2003–2004, the stapled structure has been the dominant structure in the Australian market. The migration from passive to stapled structures was driven by REITs trying to diversify their earning streams and provide better growth opportunities. Stockland was the first stapled security listed on the ASX in 1988. As of October 2010, 58 percent of entities listed on the ASX/S&P 200 A-REIT index were stapled.¹³

¹⁰Data are from FTSE EPRA/NAREIT Developed REIT Index, October 2010.

¹¹Australian Prudential Regulation Authority, “Quarterly Superannuation Performance,” Commonwealth of Australia (June 2010):5 (www.apra.gov.au/Statistics/loader.cfm?csModule=security/getfile&PageID=26180).

¹²Simon Hedger, “Listed Property Sector—Has Been or Hot Property?” *Portfolio Construction Journal*, vol. 3, no. 2 (Summer 2006/07):27–30 (http://portfolioconstruction.com.au/obj/articles/pcj_v3i2_principal.pdf).

¹³Data obtained from ASX (Australian Securities Exchange): www.asx.com.au.

Increased gearing in mid- to late 2000s. REITs had been steadily increasing their gearing up until the market crash. This increase was accomplished through existing vehicles and the adoption of more sophisticated debt structures. The credit market crash made it difficult for many REITs to refinance debt tranches.

Market crash and recapitalization in 2008–2009. A turnaround in the capital management decisions of many REITs occurred within the sector beginning in 2008. Highly geared balance sheets, an illiquid credit market, and asset devaluations forced many REITs to lower their debt ratios through asset sales and/or equity raisings. A larger number of REITs raised equity in the second half of calendar year 2008 and into 2009, thus better positioning themselves for future growth.

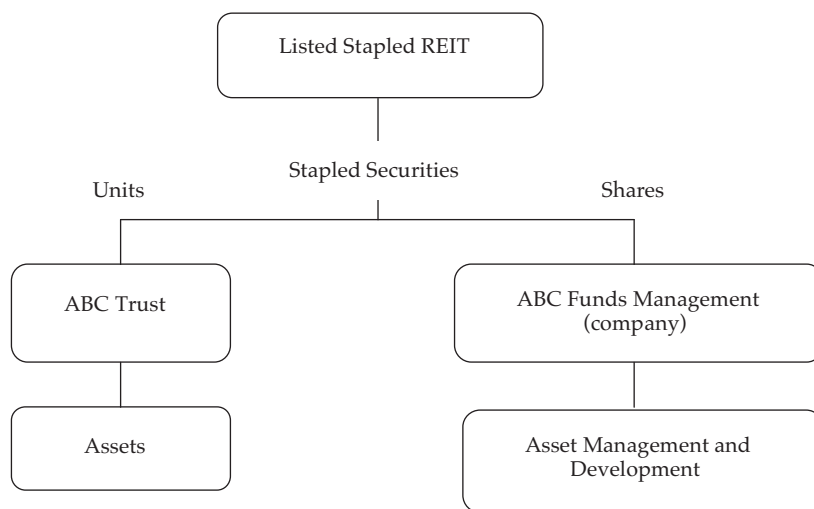
Corporate restructuring in 2009–2010. The management of several trusts was either transferred to third parties or internalized as the responsible entities and sponsors were rethinking their real estate platforms. For example, Macquarie Group internalized the management of one of its listed trusts and sold the management rights to three others.

Structure. There are two common REIT structures in Australia, both of which are based on a closed-end unit trust:

- Standalone unit trust, which is externally managed (described in Section 2), and
- The stapled security, which is internally managed.

Although externally managed REITs have been the typical management structure, there is a trend in Australia toward internal management structures that include stapled securities. As mentioned in Section 2, management services in stapled securities are carried out by an internal management company that is “stapled” to the trust (see [Figure 6](#)). The trust continues to hold the assets, but the company is able to carry out property development and funds management, which are prohibited within the trust structure. The trust and the company are listed and traded on the stock exchange as one entity, and investors buy shares in the stapled security, which entitles them to any dividends paid by the company and any distributions paid by the trust.

Figure 6. Diagram of a Stapled Structure



Source: Information from the Australian Securities Exchange, 2010.

All fees are internalized in this structure because the company bears all the management and overhead costs of the trust. As investors have a beneficial interest in the company and the trust, an external fee structure is no longer as important.

From the point of view of investors, an externally managed REIT gives pure exposure to real estate assets and the underlying rental income. By contrast, the stapled security provides exposure to property development, management, and other real estate related activities.

Regulatory Framework

Governing laws and regulatory body. A-REITs are managed investment schemes (MIS) governed by the Corporations Act 2001 (Corporations Act) and regulated by the Australian Securities and Investments Commission (ASIC). Chapter 5C of the Corporations Act on managed investment schemes deals with the registration and ongoing regulations for all MIS, including A-REITs. A-REITs are also subject to the ASX listing rules as well as the general law of trusts.

For A-REITs to qualify for tax pass-through and other tax concessions, they also need to meet certain requirements under the general trust provisions of Division 6C of Part III of Income Tax Assessment Act 1936 (ITAA 1936) and other Australian tax laws.

Australia does not have a separate code or REIT regime.

Introduction of the Managed Investments Act 1998 (MIA). Prior to 1998, managed investment schemes were governed by a dual-party system (similar to Hong Kong and Singapore) known as the prescribed investments system. Consistent with the traditional trust model (see Section 2), there was a separate manager and trustee. The MIA, which inserted Chapter 5C into the Corporations Law (replaced by the Corporations Act 2001) to remove the dual-party system provisions, introduced a new structure for managed investment schemes in which a single responsible entity (RE) would take on the function of both the trustee and the manager.

The goal of the new legislation was to increase investor protection and to clarify the ultimate accountability to investors, which was somewhat blurred in the previous dual-party system.

The impetus for change was chiefly the growth in the industry in the 1980s and 1990s and the subsequent crash in the commercial property market, which highlighted deficiencies in the regulation of managed investment schemes. The significant growth was fueled by the deregulation of financial markets in the 1980s and the introduction of compulsory superannuation in 1992.

Key requirements under the Corporations Act 2001. The main requirements under the Corporations Act 2001 as they apply to A-REITs are outlined in this section.¹⁴

1. **Registration:** All A-REITs are required to be registered as managed investment schemes with the ASIC. To be registered, the REIT needs to have a:

a. Responsible entity

The responsible entity (RE) needs to be a public company that holds an Australian financial services license. The RE operates the scheme and performs the duties conferred on it by the scheme's constitution. The RE is responsible for holding the scheme property on trust for members; therefore, it acts as both the manager and trustee. It has the ability to appoint an agent (custodian) to hold the assets on behalf of investors; however, ultimate responsibility lies with the RE.

b. Constitution

The constitution sets out the rules of the scheme including the powers of the RE. The constitution must be lodged with ASIC. It can be changed by special resolution of the members or by the RE if the RE reasonably considers the change will not adversely affect members' rights.

c. Compliance plan

The compliance plan is recorded with the ASIC along with the constitution. It outlines adequate measures that the RE needs to apply in operating the scheme to ensure compliance with the Corporations Act and the scheme's constitution. The plan must be signed by all the directors of the RE and audited annually by an external auditor.

2. **Governance:** The Corporations Act outlines specific governance measures that need to be adhered to by all REITs, and they include the following.

¹⁴Refer to the Australian Corporations Act 2001 (<http://scaleplus.law.gov.au/ComLaw/Legislation/Act1.nsf/0/618AABD8E453AE27CA256F72000C6CC1?OpenDocument>).

a. Board of directors/compliance committee

A compliance committee must be established if less than 50 percent of the directors on the board of the RE are not external directors. If established, it must have at least three members, and a majority of them must be external members. The compliance committee is required to monitor the RE and how it complies with the scheme's compliance plan.

b. Voting

Members have a right to call a members' meeting and to propose resolutions if they have at least 5 percent of votes or at least 100 members. They may request that the RE call the meeting, or they may call the meeting themselves, although at their own expense. An ordinary resolution is passed by a simple majority, and a special resolution is passed by 75 percent or more of the votes present either in person or by proxy.

Members also have the right to remove the RE by an ordinary resolution. The RE is allowed to participate in the vote if the scheme is listed. Members, however, do not vote for the directors of the responsible entity.

c. Annual general meetings

There is no legal requirement under the Corporations Act that mandates registered schemes hold regular annual general meetings.

d. Related-party transactions

Member approval is required for any transaction in which a financial benefit that comes out of the scheme property or that could endanger the scheme property is given to the RE or its related parties. Section 229 provides examples of "giving of a financial benefit," such as buying an asset from, selling an asset to, supplying services to, or receiving services from the related party. Related parties or associates must not participate in the vote to approve a related-party transaction.

The RE and its associates are not entitled to vote on resolutions if they have an interest in the resolution in any function other than as a member (Section 253E). As mentioned earlier, however, this rule does not apply to a resolution to remove the RE of a listed scheme.

e. Disclosure—offer documents

When REITs are issued to retail investors under an IPO, the RE must issue a product disclosure statement (PDS). The PDS must comply with the Corporations Act in terms of content requirements, including a fee template. The Corporations Act also requires that the PDS be written in a clear, concise, and effective manner to encourage shorter offer documents. There are also rules on forecasts and historical financial information. If the entity is stapled, then it must comply with PDS and prospectus requirements and a combined document can be issued. The PDS/prospectus must be recorded with the ASIC.

f. Periodic reporting

Under the Corporations Act and the ASX listing rules, the RE is obliged to prepare annual and half-year reports that must be filed with the ASIC and ASX.

3. Takeovers: Takeover legislation for companies was extended to listed trusts in 1999 (effective 2000). The two main requirements are:

a. 20 percent takeover threshold

A person/company cannot acquire more than 20 percent of the interest in a REIT without making a formal takeover bid or obtaining investor approval.

b. Substantial shareholding disclosure

Investors that hold more than 5 percent of a REIT must disclose their interest to the market. They must also disclose if they have a substantial holding in the company or scheme and a movement occurs of at least 1 percent in their holding (Section 671B).

Requirements under the ASX listing rules. When REITs list on the ASX, they need to adhere to the numerous listing rules.¹⁵

The following are the key requirements that apply to REITs.

1. General corporate governance requirements

The ASX Corporate Governance Council published its revised corporate governance principles and recommendations in 2010, and they are applicable to all ASX-listed entities.¹⁶ The principles and recommendations cover board composition (including director independence), board committees, continuous disclosure, and internal controls. The recommendations are not mandatory but follow an “if not, why not” disclosure approach.¹⁷ Companies are required to follow the best practice recommendations and state the level of compliance in their annual report. If they do not follow any of the recommendations, the company must disclose the recommendations and state why they were not followed.

2. Anti-dilution requirements

Under Chapter 7 of the ASX Listing Rules, listed companies and trusts are unable to issue more than 15 percent of their securities during any 12-month period without investor approval.

3. Related-party transactions

An entity cannot acquire or dispose of substantial assets to or from a related or interested party or associate without unitholder approval. An asset is considered “substantial” if the value exceeds 5 percent or more of the equity interests in the entity in its last accounts submitted to the exchange (Chapter 10).

4. Continuous disclosure

Under Chapter 3 of the ASX Listing Rules, listed companies, including trusts, must immediately disclose to the ASX any price sensitive information that might have a material effect on the share price.

5. Management agreement

Management agreements are put in place between the REIT and the appointed manager. This agreement contains all the terms and conditions in which the manager must manage the assets. ASX affirms that investors should receive quality disclosure about management agreements so they are able to make informed decisions based on the disclosure. ASX also recommends listed entities provide a clear summary of management agreements in IPO documents and make the full agreement available to investors.

Change-in-control provisions, which include pre-emption clauses over co-owned assets, must be clearly stated and fully disclosed. Investor approval is also needed for material changes to the management agreement.

REIT characteristics

1. Leverage

No restrictions are placed on the amount of leverage a REIT can hold. Restrictions exist only if the A-REIT is either foreign controlled or if the REIT controls a foreign entity.

2. Distribution

No rules define how much a REIT is allowed to distribute to investors. There are significant tax benefits available to REITs that maintain high payout ratios. The major benefit of the trust structure is that income generated by the trust flows to unitholders and is taxed once—on each unitholder’s share of the trust’s net income. The trustee (RE) is not taxed. If the trust chooses to distribute less than 100 percent of its income, then the trustee will be taxed on the proportion that is not distributed and assessable to unitholders. The trustee is then taxed at the highest marginal tax rate of 46.5 percent (Section 97 ITAA 1936).

¹⁵Please see the ASX Listing Rules located at www.asx.com.au/compliance/rules_guidance/listing_rules1.htm for more information.

¹⁶ASX Corporate Governance Council, “ASX Corporate Governance Principles and Recommendations with 2010 Amendments,” 2nd ed., Australian Securities Exchange (August 2007): www.asx.com.au/about/pdf/cg_principles_recommendations_with_2010_amendments.pdf.

¹⁷This approach is consistent with the “comply and explain” approach used in Hong Kong and Singapore.

Japan

Background. The history of the REIT market in Japan, commonly referred to as the J-REIT market, is still very young. It was formally introduced in November 2000.

In May 2000, the Investment Trusts and Investment Corporation Law (ITL) was created as a result of a revision and renaming of its predecessor, the Law Concerning Securities Investment Trusts and Securities Investment Corporations, which had been designed to regulate collective securities investment schemes. The revised law had been expanded to include real estate beside securities as the objects of management by investment trusts and investment corporations. Although it had previously been possible to invest in real estate (e.g., through investment funds), the revised law permitted new forms of real estate investments, such as through a trust or through an investment company.¹⁸

The first successful listing on the newly formed J-REIT market took place on 10 September 2001, after the Tokyo Stock Exchange (TSE) had created a listing system for REITs to trade on its market.¹⁹ After a very slow start, the number of listings grew to 42 listings by 2007. Of these, 41 were listed on the TSE and one was listed on the JASDAQ securities exchange, a separate market segment in Japan. The total market value of J-REITs at the peak in May 2007 was ¥6.8 trillion. Major factors that positively contributed to the emergence of a sizable market for J-REITs included revisions to taxes imposed on the sale and dividends of J-REITs, the construction and publishing of the TSE REIT Index, the use of two J-REITs in an index by MSCI, and deregulation that allowed funds-of-funds to invest in J-REITs.²⁰

Structure. REITs in Japan come in two types of structures—investment trusts and investment corporations. In practice, all listed J-REITs are investment corporations because of the better governance structure and requirements of the TSE. Investment corporations, which in the case of J-REITs are special-purpose entities, are established with the objective of owning and managing real estate. Although the corporation is technically responsible for owning and managing the real estate properties, in reality the management function is subcontracted to a third party, which leaves the investment corporations free to engage in such activities as issuing bonds, borrowing funds, or issuing new investment units.

The investment corporation's main function is to hold assets, and it is required to outsource asset management along with custody and general administrative functions to third parties. The actual management of J-REIT assets is performed by the asset management company, which does not need to be listed.

Figure 7 depicts the investment corporation structure for listed J-REITs.

Regulatory Framework

Governing laws and regulatory body. The emergence of the current J-REITs was made possible by the creation of the ITL in 2000. The ITL is the principal governing set of rules for J-REITs.

Besides the ITL, another key piece of legislation and regulation relevant to J-REITs is the Financial Instruments and Exchange Law (FIEL) and, in particular, its regulation of asset management companies of J-REITs. According to FIEL, asset managers are obliged to prepare and publish management reports at least once every six months.²¹

Currently, all J-REITs are listed on the TSE, although there are cases of concurrent listings on other domestic market segments. One requirement for listing on the TSE is that the asset manager entrusted with asset management of an investment corporation listed on the TSE be a member of the Investment Trusts Association, Japan (ITA). This organization is a self-regulatory body, and asset managers for J-REITs listed on the TSE are obliged to observe its voluntary regulations by

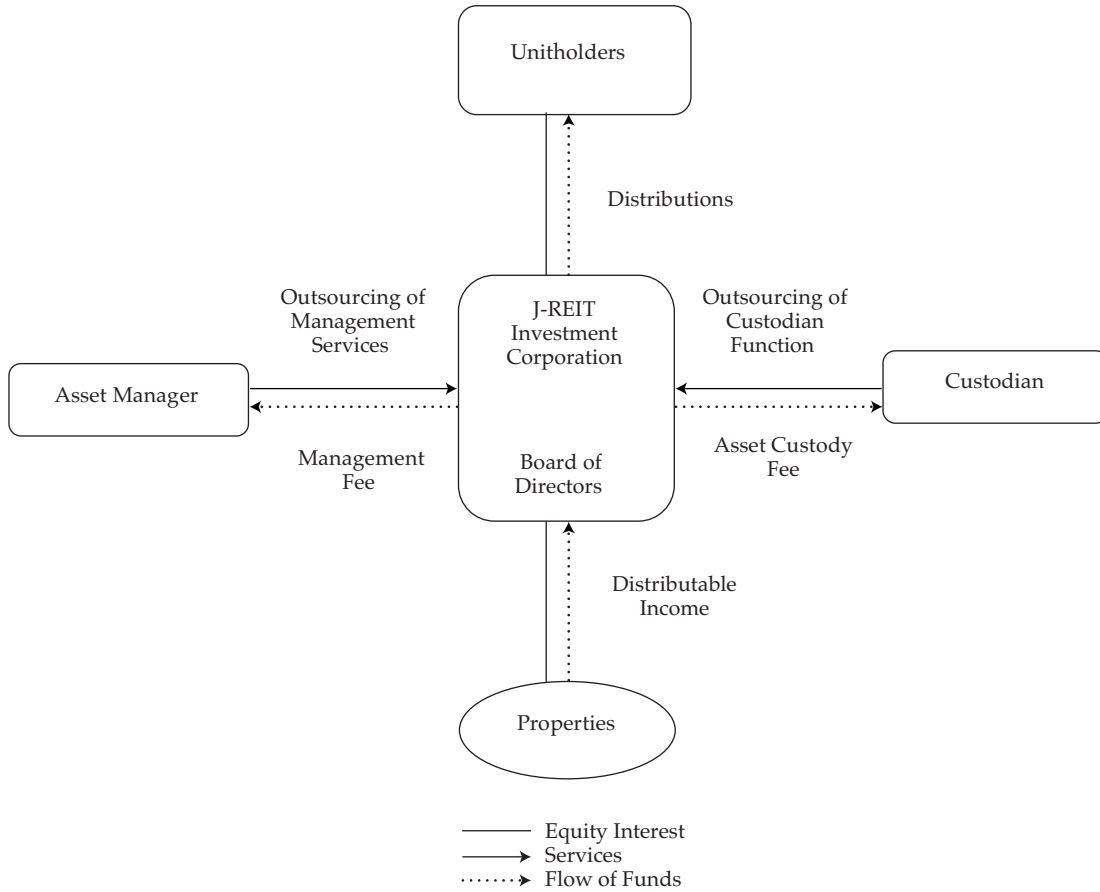
¹⁸For further details, see the *Act on Investment Trusts and Investment Corporations* at www.japaneselawtranslation.go.jp/law/detail/?id=1903&vm=04&re=01.

¹⁹A provisional reference translation of the Securities Listing Regulations of the Tokyo Stock Exchange as of March 2010 is at www.tse.or.jp/english/rules/regulations/securities.pdf.

²⁰Hiroto Iwasa, "J-REIT Market Trends—Implications of the Growth of Index Funds," Financial Research Group, NLI Research Institute (31 January 2007): www.nli-research.co.jp/english/economics/2007/eco070131.pdf.

²¹An English version of FIEL can be found at www.fsa.go.jp/en/news/2008/20080627-4/02.pdf.

Figure 7. Investment Corporation Structure for Listed J-REITs



virtue of the TSE listing rules. Areas that fall under the scope of regulation by the ITA include real estate valuation, standard price calculation of the net asset value of the fund, and calculation methods regarding distributable earnings.

The principal regulator of the J-REIT is Japan’s Financial Services Agency (the FSA). Investment corporations must be registered with the FSA before commencing any investment activity.

Key requirements under the ITL: Governance

1. Board

Investment corporations have boards of directors that are responsible for governance duties, such as monitoring asset management and investment performance, as well as conducting unitholder meetings. The board of directors of a J-REIT must have at least one executive director and two supervisory directors. Executive directors are similar to the executive directors at other listed companies in that they conduct the daily operations of the investment corporation. The board must also have supervisory directors that supervise the execution of duties of the executive directors and perform a variety of auditing functions.

Both the supervisory directors and executive directors are selected at a general unitholders’ meeting. In addition, investment corporations must also have independent auditors who are certified public accountants or auditing firms.

2. Voting

Unitholders have the right to vote at general unitholders’ meetings, and each investor has one voting right per unit. Major relevant decisions that unitholders can influence include:

- Appointment and removal of corporate officers, supervisory officers, and accounting auditors by resolution at an investors’ meeting.

- Appointment and removal of the asset management company.
- Change of an investment corporation's certificate of incorporation after its establishment by resolution at an investors' meeting.

3. Meetings

Unlike listed corporations, it is not mandatory for J-REITs to hold at least one meeting per year. Although there are no regulations concerning how frequently the general meetings with unitholders are to be organized, they must be held at least once every two years because executive officers may only be elected for a maximum of two years.

4. Takeover

Takeover of a J-REIT by means of a merger with another entity is generally possible and requires the adoption of a resolution at the unitholders' meeting by super-majority vote. A super-majority vote means an affirmative vote by two-thirds or more of the units held by the unitholders present at a unitholders' meeting, on the condition that the unitholders holding more than half of the total issued and outstanding units are present at the meeting.

5. Related-party transactions

The issue of related-party transactions has been taken seriously by regulators and to a certain extent by asset managers and investment corporations. Many asset managers have created their own codes of conduct for transactions with related parties.

The ITL, for example, stipulates that a registered investment corporation may not engage in transactions with corporate officers, supervisory officers, or its asset management company, excluding the transactions that are unlikely to compromise the protection of the investors of the registered investment corporation. The relevant types of transactions are listed in detail in the ITL and include the acquisition and transfer of securities and entrustment of the management with real property.

J-REITs are obliged to provide a report detailing transactions with the REIT sponsor. In particular, with respect to acquisitions and dispositions with related parties, J-REITs must disclose the price, date, reason for the purchase or sale, and the reason for determining that the price is fair and reasonable. In general, it is also mandatory for the asset management company managing the assets of a J-REIT to disclose information on RPTs.

Neither independent unitholders nor the board of the REIT is required to approve RPTs.

6. Disclosure

Disclosure requirements for J-REITs are similar to those that apply to investment firms or stocks of listed companies. The TSE listing rules stipulate that the issuer of a listed J-REIT—that is, the investment corporation—shall provide timely disclosure of information concerning the listed investment trust security, the issuer of the security, and the assets under management. Major disclosure requirements for J-REITs are covered by FIEL and the ITL, as well as by TSE listing regulations, and include:

- Immediate disclosure of important facts by the J-REIT, such as decisions on secondary offering of investment units, reverse splits, or splits of investment units.
- Timely disclosure regarding transfer or acquisition of an investment asset by the asset management company.
- Obligation to report (under the ITL) the details of specific material information, such as related-party transactions.
- Periodic issue of securities reports as part of ongoing disclosure requirements based on FIEL.

7. Issue of new units

A J-REIT may issue additional units in any manner and on such terms as it deems appropriate, subject to the provisions of the ITL and approval of the board of directors. Unitholder approval is not required.

Existing unitholders have no preemptive right to purchase units issued in any offering. Any such offering of units would cause dilution of the investment by existing unitholders' investment.

REIT characteristics

1. Leverage

There are no leverage restrictions.

2. Dividend payout

At least 90 percent of distributable income has to be paid as dividends to satisfy the requirements for a dividends-paid tax deduction.²²

Singapore

Background. The Monetary Authority of Singapore (MAS) first introduced rules to regulate Singapore REITs (S-REITs) in 1999. Three years later, CapitaMall Trust was the first S-REIT launched. S-REITs experienced exponential growth during the following five years, during which a total of 20 S-REITs listed and traded on the Singapore Exchange (SGX) Mainboard.

The market, however, halted completely in 2008 and 2009 as a consequence of the global financial crisis. The market started to pick up in 2010 with three S-REITs listing during the year.²³

In less than a decade, S-REIT regulations have experienced several changes. In 2002, for example, the MAS Guideline for Property Funds was incorporated into the Code of Collective Investment Schemes (the Code). This Code has become the main regulation for S-REITs.

In 2005, the MAS released a consultation paper to enhance the regulatory regime governing S-REITs. The consultation led to a tightening of the entrance requirements for S-REIT managers, augmenting the requirements applicable to related-party transactions, and modification of the valuation requirements. At the same time, the revision also gave S-REITs more flexibility to manage their capital structures and to facilitate overseas acquisitions.

In addition, several regulatory and tax measures were introduced by various government entities in 2005 to foster the growth of S-REITs market. Among the measures was a waiver of the 3 percent duty on the transfer of properties into listed S-REITs.

In September 2007, the MAS revised the Code again, and the revisions included a range of improvements to disclosure requirements, allowable investments, and other areas of REIT regulation.

Responses to another consultation in January 2009 resulted in a revision to the Code to introduce mandatory annual general meetings (AGMs) for all S-REITs. In May 2010, the MAS proposed amendments to the Code on Collective Investment Schemes, with the goal of providing clarity, increasing the flexibility for managers in managing their funds, and enhancing investor protection.²⁴

All these regulatory changes were not only intended to help promote the S-REIT market but also intended to tighten regulatory requirements that protect S-REIT unitholders.

Structure. Under Singapore's regulatory requirements, S-REITs can be either a corporation or a trust. Currently, because of differences in tax treatment, all S-REITs are listed in the form of a unit trust. The S-REITs, therefore, need to comply with the SGX listing requirements. In particular, their assets must be at least S\$300 million, and 25 percent of the units must be held by at least 500 public unitholders.

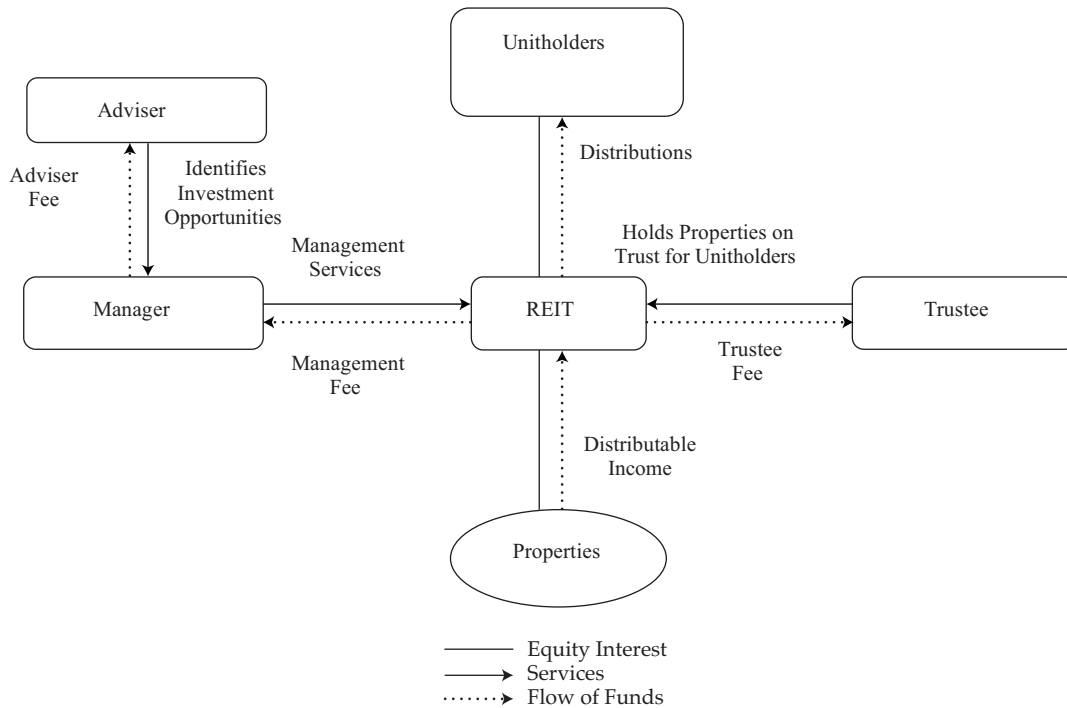
As **Figure 8** shows, S-REITs are closed-end funds and are managed externally by asset managers.

²²Ernst & Young, "Global Real Estate Investment Trust Report 2010: Against All Odds," (2010):49 ([www.ey.com/Publication/vwLUAssets/Global-REIT-report-2010-Against-all-odds/\\$FILE/Global_REIT_report_2010_Against_all_odds.pdf](http://www.ey.com/Publication/vwLUAssets/Global-REIT-report-2010-Against-all-odds/$FILE/Global_REIT_report_2010_Against_all_odds.pdf)).

²³Cache Logistics Trust in April 2010, Mapletree Industrial Trust in October 2010, and Sabana REIT in November 2010.

²⁴MAS press release on Consultation on Proposed Amendments to the Code on Collective Investment Schemes, 17 May 2010 (www.mas.gov.sg/resource/publications/consult_papers/2010/CIS_Code_Consultation_17_May_2010.pdf).

Figure 8. Typical Structure for Listed S-REITs



Regulatory Framework

Governing laws and regulatory body. The MAS is the regulatory body overseeing all the collective schemes listed at the SGX, including S-REITs. Because all S-REITs are listed, they must also comply with the Singapore Listing Rules. The main laws/rules governing S-REITs are (1) the MAS Code on Collective Schemes (last updated 11 November 2009), (2) the Securities and Futures Act, and (3) the Singapore Companies Act.

Key requirements under the Code.²⁵ The MAS guide for S-REITs is the Code on Collective Investment Schemes, a nonstatutory code that defines and stipulates duties and responsibilities of controlling unitholders, trustees, managers, and advisers. The Code also stipulates the other regulatory and governance terms for S-REITs.

1. REIT requirements

a. Manager

The manager has to be a corporation with a physical office in Singapore, a local CEO, and at least two full-time professional employees. The manager has to have at least five years of experience in managing property, and employees of the manager must have at least five years of relevant experience. The manager must also abide by the Code of Corporate Governance, where applicable, in regards to listed companies.²⁶

b. Adviser

The adviser need not be independent of the manager and may act as an agent seeking investment opportunities for the REIT or as an agent in managing the property fund's real estate assets. The adviser must be approved by the trustee and have at least five years of experience investing or advising on real estate assets.

²⁵Please refer to the MAS Code on Collective Investment Schemes (last updated 11 November 2009) at www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/CIS_Code_11_Nov_2009.pdf.

²⁶MAS, Section 8.5, in *Securities and Futures Act (CAP. 289): Guidelines on Criteria for the Grant of a Capital Markets Services Licence and Representative's Licence* (1 October 2002, updated 14 May 2010):11 (www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/Licensing_Guidelines_may_2010.pdf).

c. Trustee

The Code states that the trustee should exercise due care and diligence in discharging its functions and duties, including safeguarding the rights and interests of participants.

d. Trust deed

The trust deed must include how the manager can be removed, conditions around annual general meetings, and the calling of extraordinary general meetings (EGMs).

e. Valuation

A full valuation of each property in the portfolio should be conducted by an authorized and experienced valuer at least annually. The valuer should disclose to the trustee if it has other pending business transactions and should not value the same property for more than two consecutive years.

If more than one valuation is done by more than one valuer, an average of the two valuations should be used.

2. REIT characteristics

a. Joint venture (JV)

When a REIT invests in real estate as a joint owner, the fund should have the freedom to dispose of such investment. The JV agreement, memorandum, and articles of association should provide terms to protect the existing unitholders. Minimum percentage of distributable profit, veto rights, and mode for the resolution of the dispute should be included.

b. Leverage

The limit on aggregated borrowings is 35 percent of the S-REIT's deposited property. If a credit rating is obtained and disclosed, the limit can raise to 60 percent. As long as the leverage is still above 35 percent, the S-REIT has to maintain and disclose the ratings continuously.

c. Dividend payout

At least 90 percent of taxable income arising from Singapore assets must be distributed annually. Any undistributed taxable income is subject to a corporate tax of 17 percent.

d. Fee structure

There are fees payable to managers and advisers. The S-REIT Guideline stipulates rules for each of these fees.

Manager. Manager's compensation details can be included in the management agreement at the time when the manager is appointed. This fee arrangement cannot be for more than five years. The fee should be clearly related to commercial services provided in the performance by the manager. All fees, including acquisition or disposal fees, must be disclosed.

If the management agreement includes a compensation provision for early termination, the amount of the fee should not be more than the sum of the fixed component of unearned management fee over the remaining term of the provision. The fee is not payable if the services are terminated for just cause, such as fraud, insolvency, or negligence. Other types of compensation provisions are only allowed if they can be clearly demonstrated to be in the best interests of unitholders and they do not materially restrict the ability of participants to remove the manager. In such cases, prior approval from the MAS is required.²⁷

²⁷MAS, "Provision 2.7: Property Fund Guidelines," in Appendix 2 of "Code on Collective Investment Schemes" (12 May 2002, updated November 2009):43 (www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/CIS_Code_11_Nov_2009.pdf).

Adviser. The Guideline vaguely states that the fees payable to the adviser cannot be more than market rate.

3. Governance

a. General meetings

With the latest revision, the S-REIT Guideline now stipulates that an annual general meeting (AGM) must be convened every year, no more than 15 months after the last AGM.²⁸ Statement of total return must be presented at the AGM. At the AGM, an auditor can be appointed and fees and expenses of the auditor are determined.

b. Voting

Other than the AGM, unitholders can convene a general meeting at the request in writing of not less than 50 participants, or participants holding at least 10 percent of the issued units.

c. Appointment and removal of managers

An S-REIT manager can enter an agreement with the REIT at the time of listing. Subsequently, the manager may be removed by a resolution passed by a simple majority of participants present and voting at the general meeting.

There should not be any arrangement in place that materially restricts the ability of participants to remove a manager at the time of listing. It can be introduced after listing, but is subject to

- Approval by an ordinary resolution passed by a simple majority of participants present and voting at a general meeting. The manager and related associates cannot vote on the resolution.
- Opinion from an independent financial adviser appointed by the trustee stating whether the arrangement is based on normal commercial grounds.

d. Related-party transactions (RPT)

S-REITs may buy or sell assets to related parties provided that adequate disclosure is made in the prospectus or circular stating the:

- Identity of interested parties and their relationship;
- Details of the assets involved in each transaction;
- Transaction prices;
- Details of valuations;
- Current and expected rental yields;
- Minimum amount of subscriptions to be received; and
- Other relevant matters.

In addition, two independent valuations are required. Among the two, at least one should be commissioned independently by the trustee. The acquisition price should not be higher than the higher of the two valuations, and the disposal price should not be lower than the lower of the two valuations. The trustee has to provide a written confirmation for the RPT.

Unitholder approval is required when the transaction is equal to or greater than 5 percent of the property fund's net asset value (NAV). In this case, the transaction should be immediately disclosed and a majority vote needs to be obtained. Interested parties cannot vote. Transactions that are equal to or less than 3 percent only need immediate announcement to the exchange.

²⁸The first AGM can be convened within 18 months of its constitution.

e. Disclosure—periodic reporting

An audited annual report must be prepared by the manager at the end of each financial year. The report must list all real estate transactions entered during the year, along with the prices and valuation details for those transactions. It must also include the real estate assets and provide detailed tenant profiles, as well as other assets the fund is holding, presented in terms of amount and percentage of total fund size. Exposure to financial derivatives, investments in other property funds, borrowing, deferred payment arrangements, operation expenses, fund performance, NAV, and listed fund prices in the beginning and at end of each financial year should also be included in the report.

f. Disclosure—offer document

The fund should disclose in the prospectus the risks specific to investing in property funds, such as diversification risk, high-gearing risk, valuation risk, and illiquidity risk. Risks associated with arrangements to enhance short-term yields while potentially diluting the long-term yield should also be disclosed with details.

g. Disclosure—management agreement

There should be clear and prominent disclosure of the terms of the management agreement and all provisions relating to fees, including the computation of fees between the fund and the manager. In situations where the manager charges a fee for acquisition or for selling real estate assets, it also should disclose the detailed fee payable to the manager, expected incremental income to the fund, and expected incremental fees payable to the manager.

4. Requirements under the Takeover Code

Takeover or merger transactions involving an S-REIT are required to comply with the Code on Takeovers and Mergers (the Takeover Code). A general offer threshold is triggered if (1) a party acquires 30 percent or more of the total units of an S-REIT or (2) a party that already holds more than 30 percent but less than 50 percent of the total units of an S-REIT acquires another 1 percent of the total units of the S-REIT in any six-month period.

Hong Kong

Background. The REIT framework in Hong Kong was established in August 2003 with the release of the Code of Real Estate Investment Trusts by the Securities and Futures Commission (SFC). Hong Kong REITs (HK-REITs) are heavily regulated in terms of legal structure, the manager and trustee, gearing, and minimum payout requirements. Greater flexibility was introduced into the REIT Code in 2005 when restrictions on overseas investment and gearing were loosened. At that time, increased governance and disclosure requirements were also introduced.

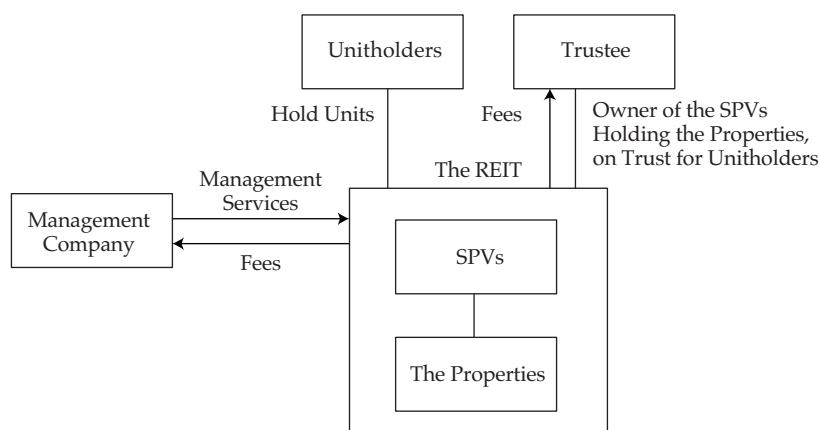
The HK-REIT market has a relatively short history. The Link REIT was the first listed on the Hong Kong Stock Exchange in November 2005. Three weeks later two more REITs listed, Prosperity REIT and GZI REIT. By 2007, seven REITs had listed. Fortune REIT listed in 2010 after first listing in Singapore in 2003. Other than this listing, there have been no new IPOs in Hong Kong. In October 2010, there were eight REITs listed in Hong Kong (with one suspended pending delisting) and the size of the HK-REIT market was US\$9.5 billion, which makes it the fourth largest market in Asia Pacific.²⁹

Structure. HK-REITs are all structured as trusts and must be listed on the stock exchange (see [Figure 9](#)). The trusts are closed-end funds, and they can be internally or externally managed (The Link REIT is the only internally managed HK-REIT).

HK-REITs are allowed to invest in real estate through a special-purpose vehicle (SPV) that is structured as a wholly owned subsidiary of the REIT and incorporated for the sole purpose of holding the assets. REITs can benefit from lower tax rates if they own property in a SPV. The after-tax distribution to the REIT from the SPV is tax exempt as is the ultimate distribution to unitholders.

²⁹Data from the FTSE EPRA/NAREIT Developed REIT Index, October 2010.

Figure 9. Typical Structure for Listed HK-REITs



Source: Information from the Hong Kong Securities and Future Commission, 2010.

Regulatory Framework

Governing laws and regulatory body. HK-REITs are regulated by the Code on Real Estate Investment Trusts (the REIT Code) and by the SFC. They are also subject to the Hong Kong Stock Exchange (HKEx) Main Board Listing Rules, as well as the general law of trusts and any applicable taxation laws (Inland Revenue Ordinance, Stamp Duty Ordinance, etc.).

Key requirements under the REIT Code.³⁰ All HK-REITs need to be authorized as a REIT by the SFC. To be authorized, the REIT needs to meet certain requirements and have certain characteristics as outlined in the following points.

1. REIT requirements

a. Trustee

The trustee and the manager must be functionally independent of each other but, under certain circumstances, are allowed to have the same ultimate holding company as long as various criteria are met, one of which is that no person is a director of both the trustee and the management company (see section 4.9 of the REIT Code). The trustee is responsible for holding the assets in trust for the benefit of the unitholders and for overseeing the activities of the fund manager to ensure it is complying with the trust deed.

b. Manager

The management company needs to manage the trust in accordance with the trust deed and is fully liable to the unitholders and the trustee. The manager must be licensed under the Securities and Futures Ordinance (SFO) and approved by the SFC to manage the trust. The licensing requirements include restrictions on the number of REITs a manager can manage and the qualifications of key personnel. It can delegate the property management duties to a third party; however, it remains fully liable to unitholders.

c. Trust deed

The trust deed outlines the rules of the trust, including the powers of the trustee and manager, as well as any fees payable. The trust deed must be recorded with the SFC, and it can be changed by special resolution of the unitholders or by the manager and trustee if they reasonably believe the change will not materially affect unitholders' interests.

³⁰Please refer to the Code on Real Estate Investment Trusts (June 2010): www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H586.

d. Property valuer

The trustee must appoint an independent property valuer that must be acceptable to the SFC (see Section 6.4 of the REIT Code). The valuer must value the property annually and carry out the valuation in accordance with standards published by the Hong Kong Institute of Surveyor or the International Valuation Standards and issued by the International Valuation Standards Committee. The same valuer can only value the REIT assets for three consecutive years.

2. REIT characteristics

a. Special purpose vehicle (SPV)

The REIT is able to hold real estate through a SPV if it remains the legal and beneficial owner of the SPV, meaning that it has majority ownership (generally wholly owned) and retains control over it. The board of the SPV must be appointed by the trustee of the REIT, and the SPV and the REIT must have the same auditor. REITs can only own hotels, recreational parks, and serviced apartments if they are owned through a SPV.

b. Joint ownership

Management companies need to ensure that REITs have majority (more than 50 percent) ownership and control of each property. If a REIT owns less than 100 percent in a property, the management company needs to disclose to investors, among other things, the ownership structure and the material terms and conditions, including fee sharing, restrictions on divestment, and the impact of such restrictions on the value of the interest in the property. The disclosure must also include the management company's rationale for the structure and a summary of the contents of a legal opinion on the structure.

c. Leverage

REITs can borrow either directly or through a SPV up to 45 percent of the total gross asset value of their trust. They must disclose their borrowing policies and maximum borrowing limits in their offer document, as well as total borrowing as a percentage of gross assets and gross liabilities as a percentage of gross assets in their interim and annual reports to unitholders.

d. Distribution

REITs must distribute at least 90 percent of their audited annual net after-tax income to unitholders.

e. Fee structure

Aggregate level of fees for investment management and property management functions should be disclosed in offer documents. Any performance fees should be paid no more than once a year and should be paid based on a "high-on-high" basis. Therefore, these fees will only be payable if management grows NAV per share to the point that it exceeds the NAV per share on which performance fees were last calculated. This method is also called the high-water-mark method.

3. Governance

a. Board

REITs do not have boards of directors, unless they are structured as internally managed REITs. The REIT Code does not give unitholders any rights to nominate, appoint, or remove directors from the board of the REIT Manager. For example, Prosperity REIT wrote in its 2009 annual report, "The appointment and removal of directors is a matter for the Board and the shareholders of the REIT Manager to determine . . . Directors may be nominated for appointment and/or removed by the Board following a recommendation made by the audit committee of the Board."³¹

³¹Prosperity REIT, "Annual Report 2009" (19 March 2010):39 (www.prosperityreit.com/upload_images/doc/320_eng_EW0808AR.pdf).

b. Voting

Two or more unitholders have the right to call a members' meeting if they hold at least 10 percent of voting rights. An ordinary resolution is passed by a simple majority, and a special resolution is passed by 75 percent or more of the votes present either in person or by proxy. All voting occurs by way of a poll.

c. Removal of the manager

In June 2010, the REIT Code was amended to allow the appointment or removal of a manager by ordinary resolution passed by unitholders. All unitholders have the right to vote, including the manager and its associates if they are unitholders.

Previously a special resolution was required, and units held by managers, directors, executives, and associates or any holders who may have had an interest in retaining the management company were excluded from the vote.

d. Annual general meeting

No requirement exists under the REIT Code that requires REITs to hold regular annual general meetings. In practice, however, the manager is required to organize a general meeting of unitholders at least once a year as specified in the trust deed.

e. Related-party transactions

There are extensive measures in place designed to prevent RPTs among HK-REITs.

Called "connected party transactions," the REIT Code defines connected parties, the categories of transactions, and what approvals and disclosures are needed to protect unitholders' rights.

A RPT is a transaction involving any connected person as defined in Section 8.1 of the REIT Code or any transaction involving two or more of the REITs managed by one management company.

Connected parties include:

- i. The management company of the REIT;
- ii. The property valuer;
- iii. The trustee;
- iv. A significant holder (owns 10 percent or more of outstanding units);
- v. A director, senior executive, or an officer of any of the entities in i, ii, iii, or iv;
- vi. An associate of the person in iv or v; and
- vii. A controlling entity, holding company, subsidiary, or associated company of any of the entities in i to iv.

Unitholders' approval by ordinary resolution and voting by poll is required for any transaction in which the total consideration of the transaction is 5 percent or more of the latest NAV as disclosed in the most recent published accounts. Any interested parties in the transaction are required to abstain from voting.

An announcement must be made for all connected-party transactions unless the value of the transaction does not exceed HK\$1 million. A brief summary of the transactions is also included in the next published interim or annual report.

The REIT Code requires that connected persons disclose their beneficial interests and any changes in the REIT's offer document, interim and annual reports, and circulars relating to related-party transactions.

f. Significant holders

The provisions of Part XV of the SFO require that any person who is interested (or has a short position) in 5 percent or more of the units as defined under the same section has a duty of disclosure to the manager and the Hong Kong Stock Exchange regarding any acquisition of, cessation of, or changes in such interest or short position.

g. Issue of new units

All new issues must be offered to existing holders on a pro-rata basis before they can be issued to new unitholders. When units are not offered to unitholders on a pro-rata basis, then unitholder approval by ordinary resolution at a general meeting is required unless the aggregate number of total new units issued during the financial year does not increase the total number of units outstanding from the previous financial year by more than 20 percent.

h. Disclosure—offer document

Authorized schemes must issue offer documents when they are listed via IPO. These must contain all the information necessary for investors to make informed decisions. The requirements for offer documents are outlined in Appendix B of the REIT Code and include the REIT's objectives, significant holders, distribution policies, and fee structures.

i. Disclosure—periodic reporting

At least two reports need to be published each financial year, and they must be submitted to the SFC (and exchange) for approval prior to dissemination to investors.

Management must keep holders informed of any material information regarding the REIT in a timely and transparent manner. All announcements must be submitted to the SFC prior to dissemination to investors.

4. Takeovers

After extensive consultation with the industry, the SFC extended the Hong Kong Codes on Takeovers and Mergers and Share Repurchases (Takeover Codes) to REITs in June 2010. Unitholders now have the same rights as shareholders in companies when it comes to takeovers. The various provisions of the Takeover Codes that now apply to REITs include the trigger provisions (Rules 26.1 (a) and (b)) and the creeper provisions (Rules 26.1 (c) and (d)), which determine when a mandatory offer is required.

Requirements under the HKEx Listing Rules. REITs are Collective Investment Schemes (CISs); therefore, the primary regulatory authority is the Securities and Futures Commission. The HKEx does not in any way regulate REITs, and its only role is to maintain, as far as practicable, a fair and orderly market in the trading of CISs. Every REIT that is listed on the exchange must sign and abide by the Listing Agreement with the HKEx and, by doing this, agrees to comply with certain continuing obligations. These continuing obligations include the disclosure of information that is relevant to holders, prompt response to enquiries made by the HKEx, and filing of specified corporate disclosure materials (e.g., circulars, annual reports, etc.) to the HKEx.

CISs are only required to adhere to certain applicable sections of the listing rules. Unlike other listed entities, however, CISs are not required to comply with Appendix 14 in the Code of Corporate Governance.

The Philippines

Background. After two years in the making, the Philippine REIT Law, officially known as the Republic Act No. 9856, was incorporated into law in December 2009. The Securities and Exchange Commission (SEC) of the Philippines approved the Implementing Rules and Regulations (IRR) of the REIT Law on 13 May 2010, and the Philippines Stock Exchange (PSE) subsequently approved the listing rules for REITs later that same month.

Although there is already interest from property companies to raise funds through spinning off assets into the REIT structure, at the time of writing, the Bureau of Internal Revenue (BIR) still had not released its implementing rules on the tax incentives for REITs. The BIR is concerned about the erosion of tax revenues if the proposed REIT regime is launched in its current form. Without an understanding of the tax consequences surrounding REITs, property companies will delay listing their assets.

The finance department, under which the BIR sits, is also delaying the implementation of REITs because it wants the SEC to change the minimum public ownership requirements for REITs. The BIR wants the SEC to update its IRR to increase the public float to more than 50 percent instead of only 33 percent. The rationale is that it is not an effective recycling of capital if the sponsor still owns 67 percent of the REIT.

SM Prime Holdings Inc and Ayala Land, two of the largest listed property companies in the Philippines, have already indicated their intention to spin off assets into REIT vehicles.³² Ortigas and Co. Limited Partnership, an unlisted property development company, also wants to raise money through a REIT.³³

Structure. REITs in the Philippines will be structured as corporations set up principally for the purpose of owning income-generating real estate assets. All REITs must be listed on the stock exchange, and they will be externally managed.

Regulatory Framework

Governing laws and regulatory body. REITs in the Philippines are governed by the Republic Act No. 9856 and its IRR, and the SEC is the responsible regulatory body.³⁴ REITs are also subject to the PSE Listing Rules, the Corporations Code of the Philippines, and the Securities Regulation Code of 2000.

Requirements under the REIT Law. The main features of REITs in the Philippines under the new regulatory framework are outlined below.

1. REIT requirements

a. Minimum public ownership and capitalization

The REIT must have at least 1,000 shareholders, each owning at least 50 shares of any class and who, in the aggregate, own at least one-third of the outstanding capital stock.³⁵

The REIT must have a minimum paid-up capital of PHP300,000,000 at the time of incorporation either in cash and/or property.

b. Fund manager

The REIT must appoint an independent fund manager who will be responsible for implementing the investment strategies of the REIT. It will also coordinate and manage property acquisition, leasing, reporting, and so on. The manager must be a registered company, be licensed by the appropriate regulatory body, and have at least three years of documented experience in the area of fund management. The fund manager can be a trust entity. The manager must have the appropriate resources to ensure that it is able to perform its duties.

c. Property manager

The REIT shall appoint a property manager who will be independent from the REIT, its promoters, and/or sponsors. It must appoint two responsible officers, each of whom shall have at least a five-year track record in property management. The property manager will be responsible for managing all the aspects of the real estate owned by the REIT.

d. Property valuer

The REIT must appoint an accredited independent property valuer to prepare a full valuation report once a year. To be independent, the valuer cannot be a subsidiary or holding company of the REIT, property manager, fund manager, or principal stockholders of the REIT or a holding company, subsidiary, affiliate, director or officer of any of the entities already listed.

³²Amelia H.C. Ylagan, "Corporate Watch: Leave Well Enough Alone," *Business World* (3 October 2010).

³³Neil Jerome C. Morales, "Ortigas & Co May Turn Greenhills Complex into a REIT," *Business World* (15 July 2010).

³⁴Republic Act No. 9856 is available from www.congress.gov.ph/download/ra_14/RA09856.pdf. Please refer to the SEC website for a copy of the IRR (www.sec.gov.ph/irr-reit-act/REIT%20IRR%20as%20approved%20on%20May%2013%202010.pdf).

³⁵At the time of writing, the minimum public ownership requirements were under review by the SEC.

2. REIT characteristics

a. Leverage

Total borrowing cannot exceed 35 percent of the REIT's deposited property value. The REIT can borrow, however, up to 70 percent as long as it has a publicly disclosed investment grade credit rating by an accredited or internationally recognized rating agency.

b. Distribution

The REIT must annually distribute at least 90 percent of its distributable income, which can be adjusted by deducting certain unrealized or nonactual gains or losses, including depreciation.

c. Fee structure

Fund manager and property manager fees must not exceed 1 percent of the NAV under their respective management.

3. Governance

a. Board

At least one-third of the board or two board members, whichever is larger, must be independent.

b. Voting and removal of the manager

Under the REIT Law, there is no mention of shareholders' right to vote for a resolution to appoint or remove the manager. The REIT Law states that "a REIT shall appoint a fund manager. . ." Although not specifically defined, the board of directors has the sole ability to appoint or remove the fund manager, without approval from shareholders.

REITs are governed by the Corporations Code; therefore, shareholders have the right to appoint directors of the REIT with a simple majority of outstanding capital or remove directors with at least two-thirds of outstanding capital.

c. Executive compensation

Total compensation of all directors and principal officers cannot exceed 10 percent of the net income before regular corporate income tax during the previous financial year.

d. Related-party transactions

Minimum requirements for related-party transactions as defined in the REIT Law include:

- i. Full, fair, timely, and accurate disclosures on the identity of the parties and their relationship with the REIT.
- ii. Contract must be on fair and reasonable terms.
- iii. Approval by at least a majority of the board, including a unanimous vote of independent directors.
- iv. A fairness opinion must be included from an independent valuer.

Nothing is mentioned about whether interested parties are required to abstain from voting, and independent shareholder approval is not required.

e. Disclosure—offer document

The REIT must disclose to shareholders a REIT plan (prospectus) that has been registered and approved by the SEC. It will include the REIT's investment policy, restrictions, and strategy, as well as other information that would be needed to enable potential shareowners to make informed investment decisions.

India

In late 2007, Securities and Exchange Board of India (SEBI) released a draft REIT regulation (SEBI Real Estate Regulation, 2008) for public comment. More than two years later it still remains uncertain whether SEBI will finalize the regulation.³⁶

According to EPRA, the total size of the real estate market in India as of October 2010 was worth US\$198 billion; of that, only 4 percent is listed.³⁷ This amount is low relative to other Asian markets, and considering that there are no listed REITs and only 16 listed property companies in India, there appears to be significant potential for the securitization of real estate assets into listed REIT vehicles.

Regulatory Framework. Under the draft REIT regulations, a REIT is defined as a trust registered under the Indian Trusts Act, 1882, and registered with SEBI, whose objective is to organize, operate, and manage real estate collective investments.³⁸

Like other REITs, the draft regulations propose a trust structure for Indian REITs, together with a trustee and real estate asset management company.

Other key features proposed under the draft regulations include:

- REITs must list their units on an exchange;
- REITs and real estate asset management companies must register with SEBI;
- REITs can invest in income generating real estate but can acquire real estate under construction as long as the value does not exceed 20 percent of the total NAV;
- REITs cannot invest in vacant land or carry out property development;
- REITs must distribute at least 90 percent of their annual net income after tax to unitholders; and
- Leverage cannot exceed 20 percent of gross assets.

From a governance perspective, the key features included in the draft regulation include:

- REITs must convene a meeting of unitholders if a requisition is made by unitholders holding at least 10 percent of the nominal value of the unit capital of the REIT or if requisitioned by SEBI in the interest of unitholders;
- Management agreements between REITs and management companies can be terminated if unitholders holding at least 75 percent of the nominal value of the capital of the REIT pass a resolution to remove the manager and receive prior approval from SEBI.
- Connected-party transactions need to be disclosed in the offer document and must be at arm's length and transparent. They also need to be valued by an independent valuer. Unitholders' prior approval is not required for transactions in which the total consideration or value of the transaction is less than 5 percent of the latest NAV and in cases where the REIT in question has not entered into a connected-party transaction with the same party during the previous 12 months.
- At least 50 percent of the asset management companies' boards of directors must be independent.

Real Estate Mutual Funds Market. In April 2008, SEBI amended the SEBI (Mutual Funds) Regulations 1996 to allow mutual funds to launch Real Estate Mutual Funds (REMFs) structures. The broad structures of REITs and REMFs are similar, although there are significant differences, including the following.

- Unlike a REIT, REMFs do not have minimum distribution requirements.

³⁶ Apurv Gupta, "REITs May Never Take Off as SEBI Has Second Thoughts," *Economic Times* (10 August 2010): <http://economictimes.indiatimes.com/markets/stocks/market-news/REITs-may-never-take-off-as-SEBI-has-second-thoughts/articleshow/6284685.cms>.

³⁷ European Public Real Estate Association, "Monthly Statistical Bulletin" (October 2010):6 (www.epra.com/media/Monthly_Statistical_Bulletin_October_2010.pdf).

³⁸ The draft REIT regulation can be found at www.sebi.gov.in/commreport/RealEstateReg.pdf.

- REMFs are not limited to investing in completed properties that generate a fixed income stream. They must invest at least 35 percent of net assets in completed properties and at least 75 percent of net assets directly in real estate assets, equity shares, or debentures of real estate companies engaged in real estate development, whether listed or unlisted.

Both REITs and REMFs must have trustees and asset management companies and are required to list on an exchange.

Challenges. There are several challenges facing the launch of REITs in India.³⁹ Various comments from the market after the release of the draft REIT regulation indicated that there is still significant work that needs to be done by SEBI and other regulators before REITs are introduced in India.

The main issues identified include:

- Clarity around taxation. The draft REIT guidelines are silent on tax provisions of REITs. Therefore, greater clarity around the tax structure and benefits need to be considered before the regime is feasible. REMFs also have no specific provisions on taxation.
- High transaction costs. Transaction costs relating to real estate transactions in India are high and enforced at the state level. Without rebates or exemptions from various stamp duties and property taxes, the ability of REITs to earn positive returns could be diminished.

Given the similarity between the REIT and REMF structures, it is possible that the two separate regimes have caused some confusion in the market, further hampering the efforts of the regulators.

China

Once developed, the China REIT (Ch-REIT) market has the potential to be one of the largest in the world. According to the property valuer DTZ, commercial property transactions in China totaled US\$12 billion in the third quarter of 2010, accounting for 40 percent of total Asian transactions for the same period.⁴⁰

China's central government started putting together plans to establish frameworks for a Ch-REIT market in 2004. By November 2008, the Chinese State Council announced its intention to introduce a legislative framework for Ch-REITs, and subsequently, a series of announcements were made by the various regulatory bodies. Because of numerous issues concerning the legal and regulatory framework, market structure, liquidity issues, tax systems, and investment restrictions, there are still many obstacles to overcome before the first Ch-REIT can be introduced.

Regulatory Framework. The key regulatory bodies for Ch-REITs are likely to be People's Bank of China (PBOC), the central bank for China; China Banking Regulatory Commission (CBRC); and China Securities Regulatory Commission (CSRC). Under the current structure, CBRC regulates the banking industry, trust companies, and trust products, while PBOC regulates interbank markets. CSRC, however, regulates securities products, securities firms, fund companies, and the two exchanges: Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange.

In light of this regulatory regime, Ch-REITs will likely be introduced with structures and operational characteristics that are different from the common REITs structures often seen in developed markets. It is expected that there will be two major types of Ch-REITs under separate regulatory regimes:

- Ch-REITs issued under the regulatory systems governed by PBOC and CBRC, to be traded in the domestic interbank market; and
- Ch-REITs issued under the regulatory platform of CSRC, to be publicly listed and traded at the exchanges.

³⁹Sachin Sandhir, "Valuation Vacuum," *Construction Week* (27 August 2009): www.constructionweekonline.in/article-5421-industry_insights_valuation_vacuum/2/.

⁴⁰Kasia Sielewicz and David Green-Morgan, "Investment Market Update, Asia Pacific Q3 2010: Strong Recovery in Most Markets, while China Remains Sluggish," DTZ Research (21 October 2010):2 (www.dtz.com/StaticFiles/Research/DTZ%20Investment%20Market%20Update%20Asia%20Pacific%20Q3%202010.pdf).

Interbank market Ch-REITs. The central bank and the banking regulator have the intention to use REITs as a tool to improve asset liquidity of commercial banks. The anticipated REITs are targeted at a designated group of institutional investors and will trade on domestic inter-bank markets only. The current regulation for “collective fund schemes” might serve as the governing regulation for this type of REIT. As investment and trading under this structure will only be limited to a small group of investors, market experts expect to see the first trial Ch-REIT to be issued under this structure.

The shortfall of this structure is its limitation on who can invest and how they can invest. Under the current law governing collective fund schemes, only a small pool of “qualified” investors can invest. The number of “qualified” investors for each fund is set at a maximum of 50. The laws also prohibit publicly soliciting sales and trading of the fund. All these restrictions will significantly constrain the potential growth of Ch-REITs.

Exchange listed Ch-REITs. The alternative, which would solve the limited investor pool issue faced by the inter-bank traded REITs, is for exchange listed Ch-REITs. The CSRC is studying whether to introduce Ch-REITs under the current platform for securities investment funds. The REITs issued under this structure would be publicly listed and traded on an exchange.

The challenge under this structure is that the current laws for securities investment funds stipulate that the proceeds raised may only be used to invest in securities tradable on regulated stock exchanges. This also means that these kinds of funds cannot purchase real estate assets directly. In addition, under the current laws and CSRC’s proposed structures, the relationship between funds and fund investors is not explicitly expressed, thereby leaving the potential that Ch-REIT investors’ rights would not be protected.

Other Challenges. Other than the limitations mentioned in each of the two alternative structures above, there are several other challenges faced by the introduction of Ch-REITs.

Taxation. The current tax regime in China does not foster a cost-friendly Ch-REIT market. Various taxes exist that would be imposed on the Ch-REIT entity and on Ch-REIT investors, including a 5 percent business tax and a 25 percent corporate tax on the Ch-REIT entity; a 30 percent to 60 percent land value appreciation tax; a 3 percent to 5 percent deed tax; and a 0.05 percent stamp tax for real estate transactions. In aggregate these taxes make the Ch-REIT very costly.

Real estate regulation framework. The current Chinese legal framework and real estate laws do not grant land ownership to individuals, so uncertainty is associated with land ownership and land usage rights for potential Ch-REITs.

Investor protection. No specific investment guidelines, no capital expenditure or gearing restrictions, and no specific fund distribution rules exist under the current regulations.

Foreign currency issue. Currently, there are restrictions for exchange-listed products for foreign investors. If Ch-REITs are made available to foreign investors, regulators will have to address this issue first. In addition, transfer of renminbi-denominated dividend payments across the border will be an issue before the renminbi can freely float.

Section 4: Cases

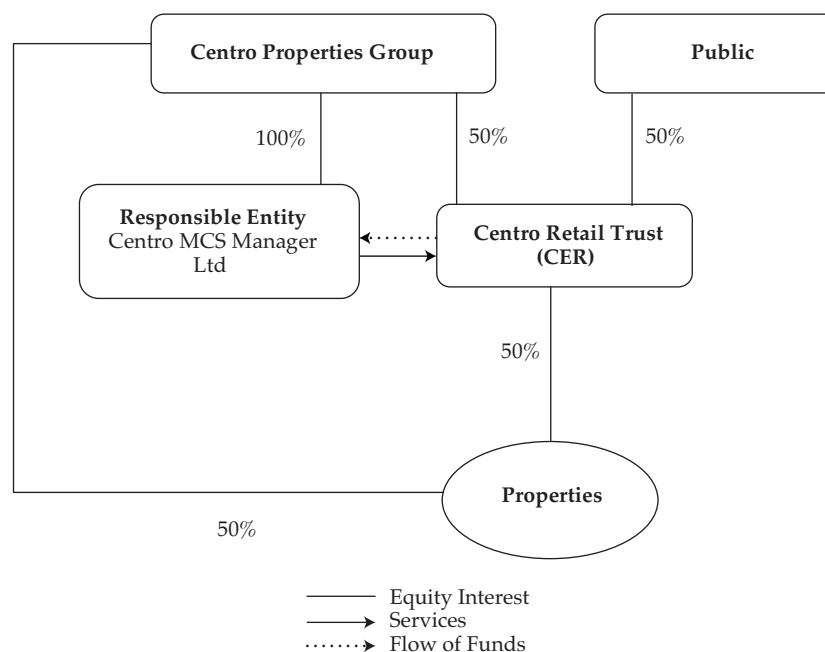
Centro Properties Group and Centro Retail Trust

Complicated Management and Ownership Structure Creates Governance Issues.

Centro Properties Group (Centro) is an A-REIT that listed on the ASX in 1997. It derives its income from owning shopping centres in Australia and the United States via its managed funds, which include listed and unlisted property investments.

In 2005, Centro spun off A\$2 billion of retail assets into Centro Retail Trust. The trust was established using an *in specie* distribution to existing Centro shareholders. Centro Retail Trust (CER) is a stapled entity combining Centro Retail Trust (trust) and Centro Retail Limited (company). Although CER is stapled, it is externally managed by Centro MCS Manager (the responsible entity), which is wholly owned by Centro, the REIT sponsor (see Figure 10).

Figure 10. Ownership and Management Structure of CER



The spin off happened at a time of consolidation in the A-REIT sector when a number of REITs were being taken over by stapled securities. At the time, this approach was a common method to increase NAV.

To fend off such an assault, Centro equipped the newly created REIT with a number of defense mechanisms. They were outlined in the product disclosure statement (PDS) filed with the ASIC/ASX:⁴¹

- Centro initially owned 50 percent of CER securities and stated in the PDS that it would keep 25–50 percent, either directly or indirectly (through its managed funds). In FY2010 Annual Report, Centro reported that it held 50.57 percent of CER.
- Centro acts as the responsible entity (RE) for CER through its wholly owned subsidiary, Centro MCS Manager.
- Centro retains a 50 percent interest in the underlying assets of the REIT.
- Centro has pre-emptive rights to acquire all or part of its remaining interest in the portfolio of assets or CER shares upon the occurrence of certain events, such as a change in responsible entity and/or a third party acquires more than 20 percent of the voting power in CER.

⁴¹Centro Retail Trust, “Product Disclosure Statement/Prospectus” (July 2005):82.

ASX gave an in-principle decision that deemed the mechanisms appropriate on the condition that the existence of and the terms pertaining to the rights of Centro be disclosed in the CER annual report for as long as the REIT is listed.

Centro, the sponsor and the substantial shareholder, had effectively entrenched itself as the RE and owner of CER. An important question from a shareholder perspective, therefore, was whether this limited the rights of the remaining 50 percent of shareholders. There are two contrasting responses to this question.

1. A 50 percent shareholding by Centro can create better alignment of interests as Centro remains interested in the performance of the assets and share price of the REIT. This alignment seemed to be true at the time of listing because the interests of CER and Centro shareholders were similar. The listing of CER would give shareholders the ability to buy/sell their shares, so the interests of CER shareholders would likely diverge from those of the Centro shareholders.
2. The entrenchment provisions essentially make it very difficult for CER to be acquired, making it unlikely that CER shareholders would ever benefit from a premium for control. The provisions also weaken the right of CER shareholders to remove the manager if they believe it was no longer managing the REIT in accordance with the set constitution.

High Leverage, Poor Disclosure, and Identical Boards—Any Connections? On 17 December 2007, Centro Properties and CER announced that they were unable to refinance A\$1.3 billion and A\$1.2 billion, respectively, in short-term debt that was expiring on 15 February 2008. Tightening credit markets had made it difficult to negotiate a refinancing package of their short-term facilities. Centro stated that it would need to lower its gearing level significantly to secure long-term financing.

In response, Centro cancelled its 1H08 (December) distribution, and its share price fell by 77 percent, destroying approximately A\$3.9 billion of shareholder value. CER also cancelled its 1H08 (December) distribution and announced that the final distribution in June 2009 would be subject to refinancing of the debt. The share price of CER fell 41 percent, destroying approximately A\$645 million of value.

Following the collapse of Centro and CER in December 2007, Centro initiated a review into the classification of debt in the 2007 annual reports. The review found that short-term debt in both Centro and CER was understated, leading not only to two class-action lawsuits being raised but a complete restructure of the governance practices of both companies. [Table 1](#) presents a timeline of the events.

Board Renewal Program. After the appointment of Paul Cooper as chairman of Centro in 2008, the company outlined a plan to “regenerate and separate” the boards of CER and Centro. At the time, the boards of CER and its RE were identical to the board of Centro (see [Table 2](#)), which presented significant conflicts of interest. Centro and CER are separate companies with different shareholders, and even though CER is externally managed by Centro, the plan called for the boards to be separate and independent so that investors’ rights would be protected.

Four new but different board members were brought onto both boards, and after the completion of the board renewal program, the board of CER and the RE were completely separate from the board of Centro (see [Table 3](#)).

Summary of Issues. The collapse of Centro was a high profile case in Australia. It was an example of a REIT overestimating its debt capacity and then failing to adequately disclose the true position to investors. There was investor backlash against the decisions of management and the board. When placed under the microscope, not only was the ownership and management structure unnecessarily complicated but the boards were also identical, which ultimately put unitholders at risk.

It is hard not to make a connection between the poor governance practices of Centro and CER and their fall from grace in December 2007. Both boards approved the 2007 audited accounts even though there were large discrepancies with the debt figures. Consequently, in October 2009, the ASIC, the Australian securities regulator, filed civil action in the Australian Federal Court against eight Centro directors and executives.

Table 1. Timeline of Events Leading to the Crash of Centro Properties and CER

| Date | Description |
|--|--|
| 15 January 2008 | <ul style="list-style-type: none"> Resignation of CEO/director Andrew Scott and appointment of Glenn Rufano Initiation of a review on the classification of current and noncurrent debt in its audited 30 June 2007 accounts |
| 15 February 2008 | <ul style="list-style-type: none"> Centro and CER granted extensions on their finance arrangements Review of Centro's debt classification found that short-term debt was understated: <ul style="list-style-type: none"> Audited financial report disclosed short-term debt of A\$1.1 billion, long-term debt of A\$2.5 billion Expect further A\$1.5 billion to be reclassified as short-term debt (from long-term); total short-term debt now A\$2.6 billion. Total debt of A\$3.6 billion unchanged Review of CER's debt classification found that the short-term debt was also understated: <ul style="list-style-type: none"> Audited financial report disclosed no short-term debt and long-term debt of A\$1.4 billion Expect an added A\$598 million to be reclassified as short-term debt (from long-term), and total debt of \$1.4 billion is unchanged |
| 12 May 2008 | Class-action lawsuit brought against Centro by Maurice Blackburn in the Federal Court in Melbourne for Centro's alleged failure to accurately disclose its true debt in 2007 |
| 26 May 2008 | Class-action law suit brought against Centro by Slater Gordon in the Federal Court in Melbourne related to Centro's alleged failure to accurately disclose the true state of its debt in 2007 |
| 13 June 2008 | Centro and CER new chairman Paul Cooper replaces Brian Healey |
| 16 January 2009 | Centro and CER finalize its long-term refinancing and stabilization plan |
| 10 August 2009 | CER new chairman Peter Day replaces Paul Cooper |
| 1 October 2009 | Centro completes board renewal |
| 6 October 2009 | CER completes board renewal |
| 21 October 2009 | Civil proceedings begin by the ASIC in federal court against eight Centro directors and executives who authorized the accounts that understated short-term debt |
| 24 December 2009 | Centro and CER appoint advisers to help restructure the Centro group, separating CER from Centro |
| 5 January 2010 | Centro new CEO Robert Tsenin replaces Glenn Rufano |
| 11 March 2010 | CER new CEO Robert Tsenin replaces Glenn Rufano |
| <i>Source:</i> Based on Centro and CER company announcements and information from the ASX. | |

MI-REIT Recapitalization and CIT Attempted Merger

Involved Parties. Figure 11 shows the connections of the involved parties in this case.

Cambridge Industrial Trust (CIT). CIT is an S-REIT established in March 2006 and listed on the SGX on 25 July 2006. CIT invests in industrial properties and has a portfolio of 42 properties. Its portfolio consists of logistics, storage and warehousing, manufacturing, and showroom facilities. In November 2009, CIT acquired 9.76 percent of MI-REIT and became the largest unitholder in MI-REIT at the time.

Cambridge Industrial Trust Management Limited (CITM). CITM is CIT's manager. It is a joint venture between Cambridge Real Estate Investment Management (CREIM), CWT, and Mitsui & Co. (Mitsui).

MacarthurCook Industrial REIT (MI-REIT). MI-REIT was incorporated in Singapore on 5 December 2006 and listed at the SGX on 19 April 2007. MI-REIT's initial investment portfolio included 12 industrial properties in Singapore. In July 2009, AIMS Financial Group acquired MacarthurCook Group in Australia. Subsequently, after completion of its recapitalization plan, MI-REIT was renamed to AIMS AMP Capital Industrial REIT.

Table 2. Board of Directors for CER and Centro Before the Board Renewal Program

| CER Board FY2007 | Centro Board FY2007 |
|--|---|
| Brian Healey (independent chairman) | Brian Healey (independent chairman) |
| Peter Wilkinson (non-executive director) | Peter Wilkinson (non-executive director) |
| Sam Kavourakis (non-executive director) | Sam Kavourakis (non-executive director) |
| Graham Goldie (non-executive director) | Graham Goldie (non-executive director) |
| Jim Hall (non-executive director) | Jim Hall (non-executive director) |
| Paul Cooper (non-executive director) | Paul Cooper (non-executive director) |
| Andrew Scott (CEO) | Andrew Scott (CEO) |
| <i>Source:</i> Information from Centro and CER Annual Report 2007. | |

Table 3. Board of Directors for CER and Centro After the Board Renewal Program

| Current Board at CER | Current Board at Centro |
|--|---|
| Peter Day (independent chairman) | <i>Paul Cooper</i> (<i>independent chairman</i>) |
| <i>Paul Cooper</i> (<i>non-executive director</i>) | Rob Wylie (non-executive director) |
| Bill Bowness (non-executive director) | Anna Buduls (non-executive director) |
| Michael Humphris (non-executive director) | Susan Oliver (non-executive director) |
| <i>Jim Hall</i> (<i>non-executive director</i>) | <i>Jim Hall</i> (<i>non-executive director</i>) |
| Fraser Mackenzie (non-executive director) | Robert Tsenin (Centro/CER CEO) |
| <i>Source:</i> Information from Centro and CER Annual Report 2010. | |

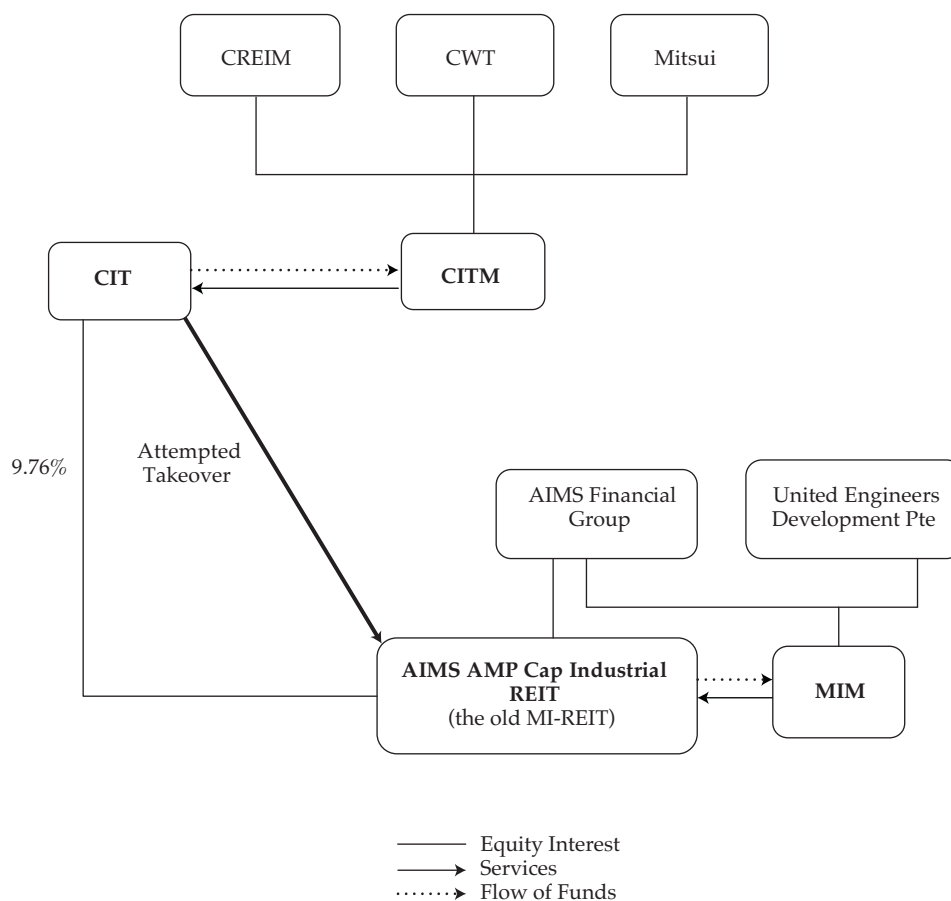
MacarthurCook Investment Managers (Asia) Limited (MIM). MIM is the manager of MI-REIT. It is jointly owned by MacarthurCook and United Engineers Development.

Description of the Case. After the global financial crisis, MI-REIT, similar to many property-related investment funds, struggled to survive. It urgently needed funding to lower its high gearing (at more than 65 percent). Without successfully raising sufficient funds, MI-REIT was at risk of being liquidated when its two debt obligations matured at the end of 2009.

In 2009, AIMS Financial Group, an Australia-based investment company created by Mainland Chinese investment professional George Wang, acquired MacarthurCook Group, MI-REIT's parent company in Australia. George Wang became MI-REIT's executive chairman by mid 2009.

At the same time, another S-REIT, CIT, was interested in acquiring MI-REIT's assets and in July 2009 proposed a merger plan that was ultimately shelved. Later that month, CIT announced a placement of 71 million CIT shares to raise S\$28 million. Early in November 2009, representatives from CIT's manager, CITM, approached MI-REIT again with a merger proposal, but the proposal

Figure 11. Structure of the MI-REIT and CIT Attempted Merger



was rejected. A few days later, CIT successfully placed its 71 million shares and used S\$10.5 million of the S\$28 million raised to purchase up to 9.67 percent of MI-REIT units, thus becoming MI-REIT's largest substantial unitholder.

Concurrently, MI-REIT announced its recapitalization plan that involved raising S\$217 million in new equity through the combination of a S\$62 million placement to two institutional investors and a S\$155 million, two-for-one rights offer for all its unitholders, including the two new institutional investors.

As the largest substantial unitholders, CIT and CITM strongly opposed this recapitalization. CIT tried to sever the deal by lobbying other MI-REIT unitholders to vote against the recapitalization. The CEO of CITM said in a SGX filing that “we are better off having MI-REIT wound up and its assets realized rather than give support to MI-REIT’s recapitalization plan.”⁴² In addition, CIT called to convene an extraordinary general meeting (EGM) to remove MI-REIT’s manager, MIM, and to appoint CITM as its replacement.

Later that month, the Monetary Authority of Singapore (MAS) indicated that it would not support the plan to have the same manager serving two S-REITs with similar investment strategies because it might create conflicts of interest.

The MAS’s decision signaled a turning point of the battle. CITM dropped the recommendation of becoming MI-REIT’s manager but continued to encourage MI-REIT’s unitholders to vote against the recapitalization plan at the EGM. On 23 November 2009, however, a simple majority of participants present and voting at the EGM approved MI-REIT’s recapitalization plan. See [Table 4](#) for a timeline of the events.

⁴²Cambridge Industrial Trust, “Cambridge Industrial Trust to Vote against AIMS Recapitalization Proposal of MI-REIT,” press release (16 November 2009).

| Date | Event |
|-------------------|--|
| 6 November 2009 | CITM submitted a recapitalization plan to MI-REIT |
| 6–9 November 2009 | CIT purchased up to 9.76 percent of MI-REIT and became a substantial unitholder of MI-REIT |
| 9 November 2009 | CEO of MacarthurCook Group wrote to CITM board of directors about the negotiation of CIT acquiring MI-REIT and the issues with the deal |
| 10 November 2009 | CEO of CIT responded to letter from CEO of MI-REIT |
| 11 November 2009 | CIT announced S\$10.5 million of the S\$28 million from the offer, and placement of units in CIT in August were used to acquire the 9.76 percent interest in MI-REIT |
| 13 November 2009 | CIT sent MI-REIT requisition to 1. Remove MIM as manager of MI-REIT 2. Appoint CITM as manager of MI-REIT |
| 16 November 2009 | CITM announced it was seeking to become the manager of MI-REIT |
| 16 November 2009 | CITM sent letter to CIT unitholders to inform them about CIT's strategic position in MI-REIT |
| 16 November 2009 | CITM, on behalf of CIT, requested an EGM to remove MIM |
| 16 November 2009 | CIT announced it would vote against MI-REIT AIMS recapitalization proposal of MI-REIT |
| 17 November 2009 | 1. CITM stated the intention to become manager for both CIT and MI-REIT 2. CITM confirmed that it had no current intention of seeking any merger arrangements with the AIMS Financial Group 3. CITM stated that its objective is not to wind up MI-REIT |
| 19 November 2009 | CIT announced that 1. CIT would vote against MI-REIT's recapitalization plan 2. CITM was in the process of finalizing refinance and equity solutions to address the problems confronting MI-REIT while preserving the value in the REIT for existing unitholders 3. CITM was encouraged by the strong response it received from MI-REIT unitholders supporting its initiative to date |
| 20 November 2009 | MAS gave the signal to discourage CITM from pursuing the management rights of MI-REIT because of its current role as manager of CIT, which imposes potential conflict of interests |
| 23 November 2009 | At EGM, MI-REIT's recapitalization plan passed by a simple majority vote |
| 30 November 2009 | Completion of recapitalization; MI-REIT changes name to AIMS AMP Capital Industrial REIT |

After the recapitalization, the new units issued constituted about 85 percent of the total units outstanding. Therefore, value for unitholders who purchased the units before the recapitalization plan was severely diluted.

For instance, the distribution per unit (DPU) for the half year before the recapitalization was 3.45 cents. The *pro forma* DPU would fall to 1.04 cents after the recapitalization, assuming everything else remained unchanged.⁴³

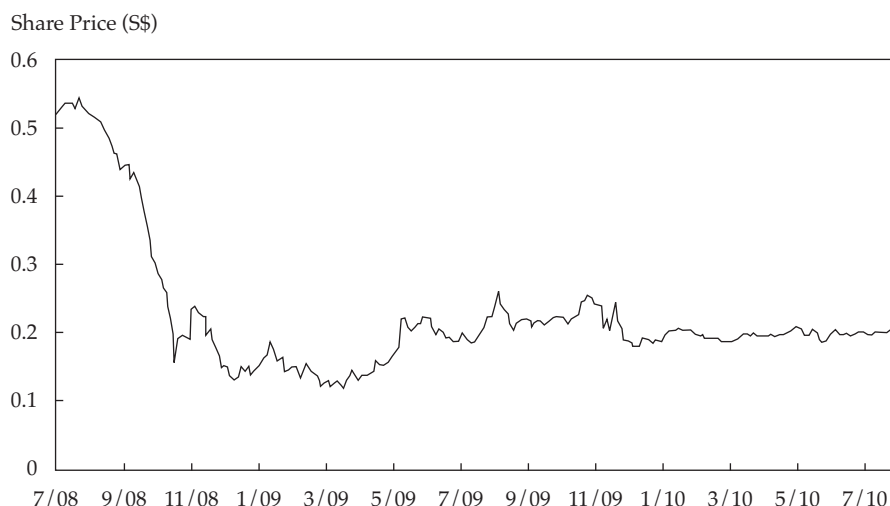
Figure 12 and **Figure 13** are price charts for MI-REIT (AIMS AMP Capital Industrial REIT) and CIT for July 2008 to July 2010. Share prices of MI-REIT declined more than 50 percent after the recapitalization and never recovered.

Summary of Issues

Dilution. Under the current S-REIT Code, existing unitholders have no pre-emptive rights and no specific provisions to impose control on possible dilution. If a REIT manager decides to issue new shares to new investors, unitholders can only vote for or against the resolution; they have no right to participate in the capital raising. In some cases when funding needs are pressing and no other better alternatives are available, investors are often forced to choose between letting their interests be diluted or letting the REIT go bankrupt.

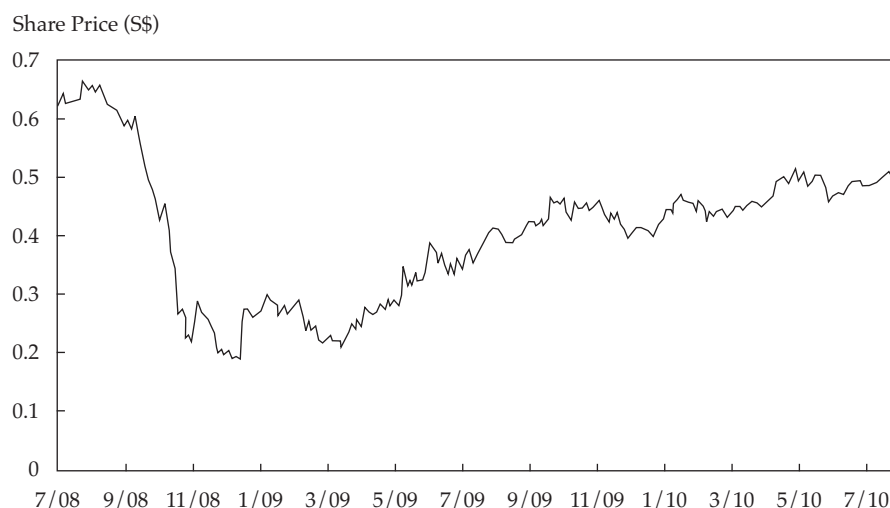
⁴³MI-REIT, "Proposed Equity Fund Raising and Acquisition by MI-REIT," SGX Announcement (6 November 2009).

Figure 12. Share Price for AIMS AMP Capital Industrial REIT, July 2008–July 2010



Source: Based on data from Bloomberg.

Figure 13. Share Price for CIT, July 2008–July 2010



Source: Based on data from Bloomberg.

Conflict of interests. No specific regulations exist that stipulate controls over an S-REIT manager who has similar investment portfolios and who manages more than one S-REIT. Investors have to speculate on regulatory rulings when a S-REIT manager tries to become the manager of another S-REIT. In particular under the current S-REIT Code, there are provisions stipulating who is qualified to be a manager of an S-REIT but nothing to restrict who cannot be a manager. The approval rights lie with the MAS, which leaves investors with high uncertainties.

Takeovers. In June 2007, the Securities Industry Council decided to extend the ambit of the Singapore Code of Takeovers and Mergers (Takeover Code) to S-REITs. The Takeover Code stipulates that when parties intend to acquire 30 percent or more of a REIT's total units, or when parties holding 30 percent to 50 percent acquire an additional 1 percent or more of the total units outstanding in any six-month period, they should make a general offer for the REIT.

This stipulation is generally in line with takeover regulations in most regulatory regimes. Some investors, however, especially the incumbent unitholders, may feel that greater certainty would be provided if there were regulatory clarification on whether the Takeover Code applies to hostile mergers when a proxy fight is involved.

Lend Lease US Office Trust

Note: Lend Lease US Office Trust changed its name in November 2003 to Principal America Office Trust (PAO). PAO delisted in November 2004 after a compulsory acquisition by Macquarie Office Trust (MOF).⁴⁴

Lend Lease US Office Trust (trust) was listed in 1999 on the ASX and was invested in the U.S. office market. It was sponsored by Lend Lease Corporation (Lend Lease), an ASX-listed integrated property company involved in property development, investment management, project and construction management, and asset and property management. The company's market capitalization as of 29 October 2010 was A\$4,077 million (US\$3,996 million).⁴⁵ Lend Lease USOT Management Limited (LLML), a wholly owned subsidiary of Lend Lease, was the responsible entity of the trust.

In June 2003, Lend Lease advised unitholders that it had contracted to sell its U.S. real estate advisory business to Morgan Stanley. Under the agreement, key personnel from LLML would transfer to Morgan Stanley and continue their role managing the trust. Lend Lease said the sale to Morgan Stanley would not affect the trust's assets and that the transition was in unitholders' best interests.

Colonial First State Investments Limited (CFSI), the largest single unitholder of the trust, opposed the sale and the changes within LLML. On 17 September 2003, CFSI sent a letter to LLML requisitioning a meeting of unitholders for the purpose of considering and voting on two resolutions.⁴⁶ Under section 601FM and Part 2G.4 of the Corporations Act 2001, unitholders holding more than 5 percent can call a meeting of members and put forward resolutions. At the time the letter was sent and the meeting was requested, CFSI held 21.7905 percent of the total units in the trust.

The first resolution was to remove LLML as responsible entity, and the second proposed the appointment of Principal Real Estate Investors (Australia) Limited (PREIA) as the new responsible entity after the removal of LLML.

CFSI submitted the proposals because it believed that the new arrangements were not in the best interests of unitholders. Specifically it did not believe Morgan Stanley's management team was experienced enough to manage the assets currently held by the trust. It favored PREIA because of its experience and track record in funds and portfolio management in the United States. Moreover, it preferred the trust be managed by a manager who has a majority of independent directors.

PREIA stated in a deed poll dated 17 September 2003 that as long as it remained the responsible entity, a majority of the directors would continue to be external directors as defined in the Corporations Act. Also in the deed poll, PREIA outlined its fee structure as the responsible entity, and under the agreement, the management fee of the trust was to be reduced from 0.5 percent to 0.4 percent of assets under management. Morgan Stanley made the same assurances to unitholders approximately one month later on 15 October 2003.⁴⁷

LLML released an independent expert report on 23 October 2003 that outlined the board's recommendations.⁴⁸ Both the board of LLML and the independent expert recommended that unitholders reject the CFSI proposal and vote against the resolutions. At the general meeting held on 14 November 2003, however, only 44 percent of votes were cast against the resolutions and consequently PREIA was appointed the responsible entity. The trust was renamed Principal America Office Trust (PAO) and continued trading under this name until it was taken over by Macquarie Office Trust one year later on 25 November 2004.

Summary of Issues. This case represents a good example of unitholders exercising their rights when they believe the responsible entity is not acting in their best interests. As noted above, unitholders in Australia have the ability to requisition a meeting and put forward resolutions for

⁴⁴Macquarie Office Trust is now called Charter Hall Office REIT (CQO).

⁴⁵Based on the AUD/USD exchange rate of \$1.02 on 29 October 2010.

⁴⁶Lend Lease US Office Trust, letter to unitholders on the notice from CFS (17 September 2003).

⁴⁷Lend Lease US Office Trust, press release, Notice from Morgan Stanley (15 October 2003).

⁴⁸Lend Lease US Office Trust, letter to unitholders and Independent Expert Report (23 October 2003).

the meeting. In this case, CFSI, the largest unitholder, gained enough support from other unitholders to oust the incoming manager of the trust. This case also represents the first time in Australian history that a manager was removed through a unitholder vote rather than a takeover.⁴⁹

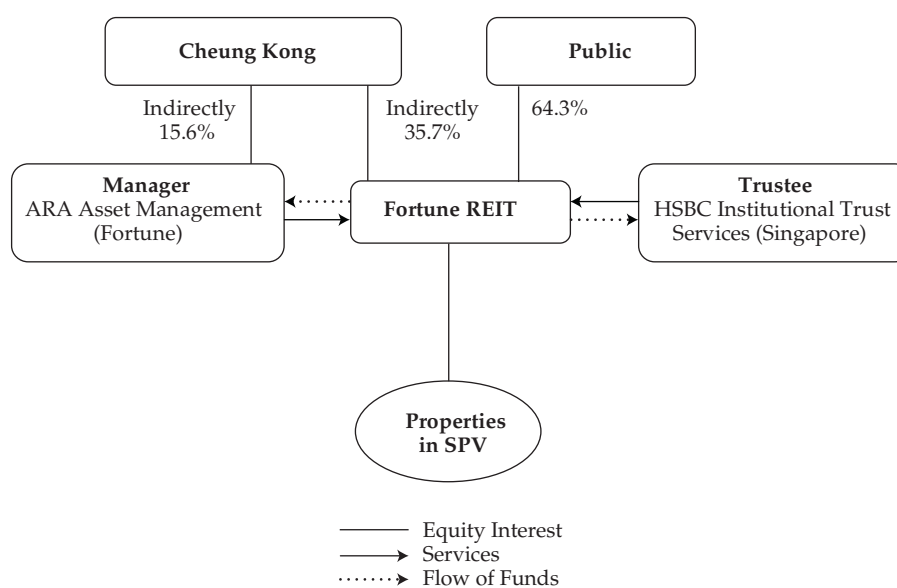
Fortune REIT

Fortune REIT was the first REIT to be listed in Singapore holding assets in Hong Kong. It is sponsored by Cheung Kong (Holdings) Limited (Cheung Kong) and was listed on the Mainboard of the Singapore Stock Exchange in August 2003. It currently holds a portfolio of 14 retail shopping malls and properties in Kowloon and the New Territories. On 20 April 2010, Fortune REIT listed on the Hong Kong Stock Exchange.

On 24 August 2009, Fortune REIT announced the proposed acquisition of three properties in Hong Kong and a rights issue to raise HK\$1.9 billion to fund the acquisitions.⁵⁰ Given the structure of Fortune REIT and the proposed capital raising, this case illustrates several governance issues that are common among REITs listed in Asia.

Fortune REIT Structure. The structure of Fortune REIT (see [Figure 14](#)), similar to other REITs in Hong Kong and Singapore, was established by its sponsor, Cheung Kong. Cheung Kong placed assets in the trust while maintaining a share of the asset management/property management rights through a partly owned company, ARA Asset Management (the manager). Cheung Kong also kept a substantial share of the voting rights in the newly established trust.

Figure 14. Structure of Fortune REIT



Cheung Kong is the second largest developer by market capitalization on the Hong Kong Stock Exchange. Its largest unitholder is Li Ka-shing, the founder, chairman, and executive director, who along with his family own approximately 42 percent of Cheung Kong. The manager is a wholly-owned subsidiary of ARA, which is also indirectly owned by Cheung Kong. ARA is listed on the SGX and is the asset manager for four other listed REITs in Singapore, Hong Kong, and Malaysia.⁵¹

As disclosed in Fortune REIT's FY2009 annual report, Cheung Kong also had a deemed interest of 35.7 percent in Fortune REIT held indirectly through subsidiaries.

⁴⁹"Principal Wins Fight for Lend Lease US Office," *Sydney Morning Herald* (15 November 2003).

⁵⁰Fortune REIT, "Proposed Acquisition and Rights Issue," Circular to Unitholders (24 August 2009).

⁵¹Suntec REIT (Singapore), Prosperity REIT (Hong Kong), AmFIRST REIT (Malaysia), and Cache Logistics Trust (Singapore).

Details on the Acquisition and Rights Issue. In the circular dated 24 August 2009, Fortune REIT described the three target properties, including the consideration to be paid, the independent valuation, and net operating yield. In the summary of the one-for-one rights issue, it noted that the manager expected to raise HK\$1,889 million by issuing 824,879,427 shares. The issue was fully underwritten, and Cheung Kong and its subsidiaries agreed to sub-underwrite the issue as well.

Dilution. Fortune REIT included *pro forma* financials that showed the effects of the acquisition and rights issue on various metrics. **Table 5** was extracted from Fortune REIT's circular.

| | Before the Acquisitions and Rights Issue | After the Acquisitions and Rights Issue |
|---|---|--|
| NAV per unit (HK\$) | 7.5 | 4.8 |
| Distribution yield (%) | 9.0 | 7.2 |
| <i>Source: Fortune REIT circular 24, August 2009.</i> | | |

The one-for-one rights issue essentially doubled the shares on issue, and the trust's NAV per unit and distribution yield were significantly diluted as a result.

Valuation. Based on information provided in the circular, the net property yields for the three properties ranged from 4.8 percent to 5.7 percent. This yield is similar to the yields on shopping malls in prime locations in Hong Kong, even though the Fortune REIT properties were in suburban areas, which suggested that the new properties were similar quality and had similar growth potential.⁵²

Fortune REIT used two independent valuers (Knight Frank and Savills) to assess the value of the properties and an independent financial adviser (KPMG) to advise on the acquisitions and rights issue.

Related-party transactions. All three transactions were flagged as related-party transactions because the vendor of each property was either a subsidiary of Cheung Kong or was somehow affiliated with the group. Because the total consideration of the properties exceeded the stated thresholds for RPTs, the acquisitions were subject to unitholders' approval in accordance with Chapter 9 of the SGX Listing Manual and Paragraph 5 of the Property Funds Guidelines. Cheung Kong, the controlling unitholder and interested party, abstained from voting. An independent financial adviser found the transactions to be within normal commercial terms.

Fees. Under the trust deed, the manager was entitled to an acquisition fee of 1.0 percent of the acquisition price of the properties, which in this case equated to HK\$20.4 million. This fee was payable to the manager in units. After the acquisition the manager would be responsible for management of the properties and so would be entitled to management fees as outlined in the trust deed. The management fees attributable to the properties comprised a base fee of 0.3 percent per year of the value of the properties, and the performance fee was collected based on 3.0 percent per year of the net property income of each property.

Whitewash waiver. Cheung Kong already held a large stake in Fortune REIT, and because it had sub-underwritten the rights offering, it may have been in a situation where it was required under Rule 14.1(b) of the Takeovers Code to make a Mandatory Offer to the existing unitholders. To get around this requirement, the manager wanted approval from independent unitholders for a waiver of their right to receive a Mandatory Offer from Cheung Kong and related parties for the units it did not already own or control. Essentially, the whitewash waiver was used by Fortune REIT to allow the rights issue to be fully underwritten. Whitewash waivers are unique to Hong Kong and Singapore.

⁵²As another comparison, Hong Kong Land (SGX: HKLand), another large developer in Hong Kong, values the Prince's Building on prime real estate in Central, Hong Kong, conservatively at only 5.5 percent (Hong Kong Land, 2008 Results Presentation).

The circular presented a table showing the number and percentage of units held by Cheung Kong (and related parties) and independent unitholders under various whitewash scenarios. If all unitholders subscribed to the rights issue and took up their pro-rata allocations, then Cheung Kong's interest would remain unchanged. Under the most extreme case, however, if none of the other unitholders subscribed for their entitlements, 100 percent of the rights units would then be taken up by Cheung Kong and its aggregated unitholding would increase to more than 65 percent.

The threat of such severe dilution would have forced many investors to accept their rights and approve the deal.

Extraordinary General Meeting. The EGM of Fortune REIT was held on 11 September 2009 for the purpose of considering and voting on three resolutions:

1. The acquisition of the three properties (ordinary resolution),
2. The whitewash resolution (ordinary resolution), and
3. The trust deed amendment to facilitate equity fund raisings (extraordinary resolution).

The independent financial adviser and the independent directors recommended that unitholders vote in favor of the all three resolutions.

On 11 September, the manager announced that all the resolutions had passed. A breakdown of the votes was not provided in the release to the exchange.

Summary of Issues. On the day of the announcement, investors dumped the stock and Fortune REIT lost 10.5 percent of its market value. The change in unit price indicated that investors did not like the deal.

High dilution and valuation. The major concern of unitholders was the extreme dilution to NAV and distribution per share that would result after effectively doubling the unit base. This fact combined with an ambitious capitalization rate made investors question whether there was any actual value creation for Fortune REIT from the deal.

Related-party transactions were rife. Cheung Kong and its related parties acted in three different capacities: as controlling unitholder of Fortune REIT, as manager of Fortune REIT, and as vendor of the properties being sold to Fortune REIT. Although the transactions were recommended by an independent financial adviser and the independent directors (representing one-third of the board) and independent unitholders then approved the deals, Cheung Kong's major involvement as both buyer and seller created a significant conflict of interest.

Fee structure. Although not a primary issue in this case, the deal highlights common problems with the fee structure of REITs. After the acquisition, the manager was entitled to an acquisition fee and would then be able to collect more fees in the form of base and performance fees because the asset base has increased. Instead of encouraging value creation and earning accretion from the manager, these types of fees act to incentivize managers to grow the asset base, which is what happened in this case.

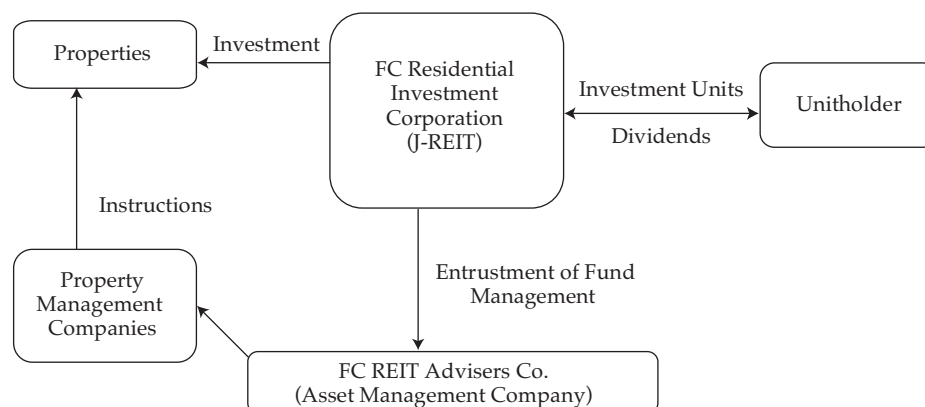
FC Residential Investment Corporation

The current structure of J-REITs provides for the possibility of conflicts of interest, especially because of the distinctive governance structures involved. An interesting case in this regard was that of FC Residential Investment Corporation (FC Residential), a J-REIT that was the subject of widespread news coverage in early 2010.

The basic structure of this J-REIT is shown in [Figure 15](#).

Interlocking Directorate and Related-Party Transaction. Of particular interest in this case was the interlocking nature of management. In early March 2010, the CEO of FC REIT Advisers, the asset management company formally entrusted by the J-REIT, also served as the CEO of the J-REIT. This interlocking directorate gave rise to potential conflicts of interest.

Figure 15. Structure of FC Residential J-REIT



Source: Information from FC Residential Investment Corporation public disclosure documents.

On 25 March, FC Residential disclosed that it had purchased real estate from a company affiliated with FC REIT Advisers. In other words, the J-REIT was buying an asset from an affiliate of its asset management company. Because the CEO of the J-REIT was also the CEO of the asset manager at the same time, there was at least temporary concern about the appropriateness of this deal among investors in the J-REIT.

Third-Party Allocation. On 6 April 2010, FC Residential announced it would privately place 27,776 units to two Tokyo-based special purpose companies affiliated with Ichigo Asset Group. The price was set at ¥180,000 per unit, or almost ¥5 billion in total. According to a company announcement, the proceeds would be used to pay back debt.

The units issued in the private placement would supplement the 32,700 units previously issued by the company, thus resulting in substantial dilution to existing unitholders. In a separate announcement, FC Residential admitted to the “temporary” dilution but argued that the capital injection would increase its credit strength because debt was repaid. Apart from this, the company argued that the deal would strengthen the REIT’s income stream because it would be able to acquire high-grade assets at low prices.

The price per unit in the private placement was set at ¥180,000, although the closing price on 6 April, the day of the announcement of the new issue, was ¥234,000. Since at least the beginning of 2010, the daily closing share price had never been below ¥180,000, and only on 29 January was the day’s low briefly below ¥180,000. According to the calculations at a major Japanese securities firm, ¥180,000 would correspond to a discount of 61 percent to book value per share based on the situation at the end of the business period in October 2009, or a 54 percent discount to estimated net asset value based on appraisal value at the same point in time.⁵³

According to news reports, the two Tokyo-based affiliates of Ichigo Asset Group involved in this deal were mainly engaged in acquiring and managing special assets. After the transaction, these two companies would become the top unitholders of the company, each with a 22.96 percent stake. The previous top unitholder’s stake would decrease to 12.56 percent from 23.24 percent, while the previous second-largest unitholder’s stake would decline to 5.37 percent from 9.93 percent. Because these two special-purpose companies are affiliated with Ichigo Asset Group, this group would become the largest unitholder, owning almost 46 percent. At the same time, FC REIT Advisers held 4.15 percent of FC Residential, which, if sold to Ichigo Asset Group, would give Ichigo more than 50 percent of total units.

The loan-to-value ratio (LTV) for FC Residential, on 25 March, when the asset purchase was made, was estimated by two major Japanese security firms to be less than 40 percent. Considering that the average LTV for a J-REIT is around 50 percent, the economic rationale for the capital injection—namely, debt repayment—was not immediately apparent to some market participants.

⁵³Nomura Securities Co Ltd, Tokyo, “Tokyo chisai ga FC residensharu no daisan wariate zoshi wo sadome,” Japanese Equity Research–Flash Report (12 May 2010).

On 26 April, SJ Securities, a financial firm that at that point in time held 7,600 units or more than 23 percent of total outstanding units, filed a petition for a temporary injunction with the Tokyo District Court. According to newspaper reports, it was argued that FC Residential executives had infringed on a rule requiring investment trusts to set prices appropriate to their assets in raising funds.

On 11 May, the Tokyo District Court approved the request for an injunction and ordered FC Residential to suspend the issuance of new shares via a private placement. Although FC Residential had objected, it had to suspend the planned issue (announced on 12 May 2010) when the Tokyo District Court confirmed the order.

Court Decision and ITL. The court's decision was based on article 82 (6) of the ITL, which stipulates the amount paid for subscribed units must fairly reflect the contents of the assets held by the investment corporation. Although there is no detailed definition about what constitutes a fair price, the court judged that "the payment amount cannot be recognized as fair value. . . and the issuance could generate irrecoverable damages for the investment corporation."

The same article (ITL 82) stipulates that in the event of a unit issue, it is the representative director of the investment corporation who has to set the major requirements, such as number of units to be made available for subscription or the amount to be paid for unit subscription. These decisions made by the representative director have to be approved by the board of directors at the investment corporation. The unitholders themselves are not entitled to participate in that decision process and do not have the right of approval. In other words, unitholders are not entitled to approve such transactions.

Summary of Issues. This particular case illustrates a number of governance issues that are common among J-REITs. Although by definition the unitholders own the J-REIT, in reality the sponsor is in a position to exercise power in such a way as to put existing unitholders at a disadvantage for the benefit of the sponsor. This situation is exactly what would have happened in this case had the court proceedings not stopped the intended arrangements. What is especially interesting is that the dealings were set up in a way that gave majority ownership to a third party through a unit allotment at a price so low that it not only prompted existing unitholders to take it to court, but for the first time ever a court made a judgment against the third party.

There appears to be room for discussion about whether unitholders' interests in J-REITs are sufficiently protected. This issue is especially important because, as documented in this case, the sponsor's actual unitholdings in the J-REIT did not need to be substantial in order to exercise economic influence.

Mori Hills REIT

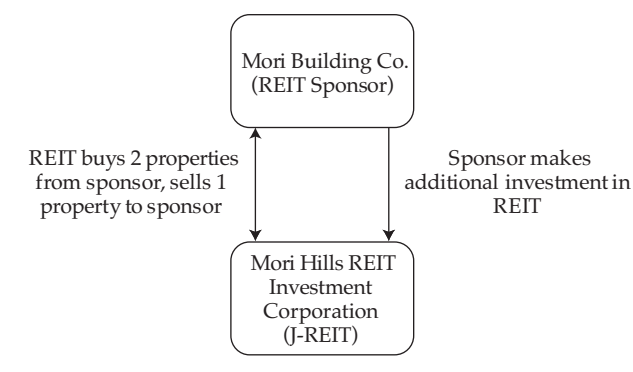
On 16 September 2008, Mori Hills REIT Investment Corporation (MHR), a J-REIT listed on the Tokyo Stock Exchange, issued a number of press releases in which it informed the public of a third-party allotment of newly issued investment units and of dealings in real estate.⁵⁴ Under normal circumstances, this news would not be regarded as noteworthy, especially given that investors in J-REITs have become accustomed to new unit placements to parties other than existing unitholders. One thing of particular interest in this case, however, was the fact that all the transactions were made with MHR's sponsoring company, Mori Building Co., Ltd. **Figure 16** illustrates the basics of the dealings involved.

According to the arrangements, Mori Building would receive all of the 29,400 new investment units to be issued by MHR. Before the planned third-party allotment, MHR's sponsor held 19,518 of the total of 129,800 units outstanding, equal to 15.0 percent of the total units outstanding. This ratio would increase to 30.7 percent as a result of the announced transactions.

The new units were to be issued for ¥500,000 each. According to the press release issued by MHR, this corresponded to a premium of 5.7 percent over the closing price prior to the day when the resolution for issuance was made. An analyst at Nomura Securities explained in a report that compared with the IPO price of ¥750,000 when the J-REIT listed in November 2006, the ¥500,000

⁵⁴Press releases can be found on the company's website at www.mori-hills-reit.co.jp/en/.

Figure 16. Basic Structure of Dealings between MHR and the Sponsor



offered per unit was very favorable for the sponsor.⁵⁵ Even looking at the book value per share of ¥573,000 as of July 2008, the same analyst suggested that the price for the new issue was advantageous to the sponsor.

The ¥14.7 billion in proceeds from this offering, MHR reported, would be used toward the purchase of two properties belonging to Mori Building, its sponsor. As part of the arrangement, MHR would sell one residential unit to the sponsor.

In terms of acquisition price, one property would be purchased for ¥5.5 billion. This property's utilization rate was 94.3 percent. Apparently MHR was optimistic about its ability to raise rents because a third-party property appraisal company valued the property at ¥5.025 billion, which was lower than the actual price of the asset transfer. In the case of the second property, MHR purchased it for ¥37.2 billion and a third-party appraisal firm estimated its value to be ¥35.6 billion.

Including rental income projections for the newly acquired properties and the revenues from the sale of the residential unit, MHR announced a distribution per unit (DPU) of ¥13,500 for the half-year ending January 2009. The DPU of the preceding period was ¥14,117. Although the effect of the new issue is not as pronounced when DPU figures for the following business period are considered, the fact remains that holdings of existing unitholders would be diluted substantially.

MHR justified the choice of Mori Building as the allottee with the then-prevailing difficult environment for obtaining funds for investment in the real estate market. At the same time, MHR held that without these additional funds an opportunity for expanding its asset scale would be missed.

An additional interpretation from the standpoint of existing MHR unitholders comes from a closer look at the proprietary relationships of the parties involved and prevailing governance practices. **Figure 17** shows the basic issues.

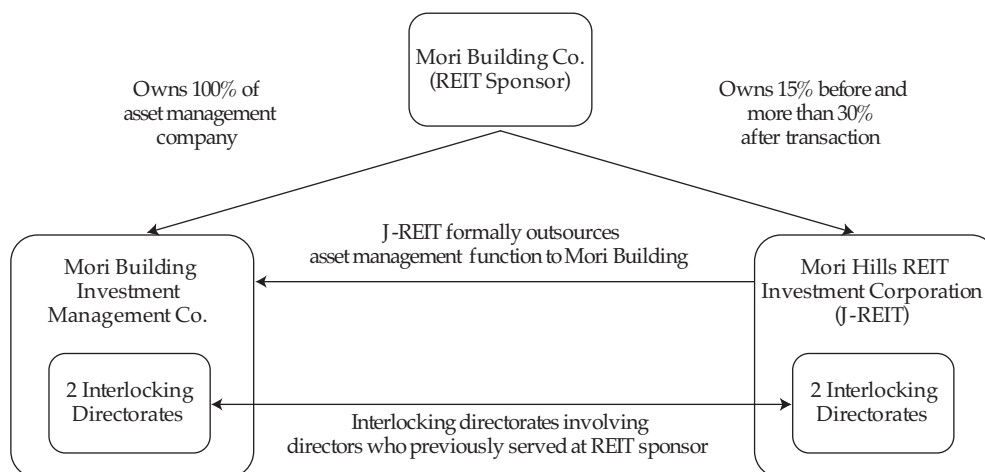
After the transactions were complete, the sponsor would hold more than 30 percent of MHR's total outstanding units. Previously, the sponsor held around 15 percent. Although these constitute transactions between related parties, namely between the J-REIT and its sponsor that at the same time holds a substantial part of the J-REIT's units, no approval by existing unitholders was needed.

The unlisted sponsor wholly owns the J-REIT's asset management company. As has been explained, the basic structure of a J-REIT calls for the outsourcing of asset management functions to an asset management firm. In this particular case, individuals who had originally served at the sponsor or a group firm were appointed as directors at the asset management firm and at the same time became executive directors at the J-REIT. These interlocking directorships can be seen as serving to further cement the ties between the listed J-REIT and its unlisted asset management firm.⁵⁶

⁵⁵Nomura Securities Co Ltd, Tokyo, "Samazamana hankyo ga yoso sareru mori hills reit no daisanshawariate to bukkenbaibai," Japanese Equity Research—Flash Report (17 September 2008).

⁵⁶Alexander Flatscher, CFA, and Lee Kha Loon, CFA, authored a report in 2010, called "Inter-Corporate Network Dealings and Minority Shareholder Protection—Cases in Japan," which presents in more detail the issues pertaining to related-party transactions in Japan. The report is available at www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n3.1.

Figure 17. Illustration of the Issues with the MHR Transactions



Notes: An executive director of MHR is concurrently the CEO at Mori Building Investment Management and had been employed by the sponsor right before assuming present functions. Another executive at MHR is serving as president of Mori Building Investment Management and was employed by a group company of the sponsor right before assuming present functions. Mori Building Co. and Mori Building Investment Management are unlisted.

Sources: Information from press release on 16 September 2008 and business period report for half-year business period until January 2009.

Considering the interests of the holders of investment units in MHR, it is at least questionable whether a situation in which MHR engages in substantial dealings with its sponsor without the necessity of approval by unitholders is desirable.

As an epilogue to this story, not only did MHR's DPU decline considerably in subsequent periods; its LTV ratio deteriorated because it continued to engage in real estate transactions with its sponsor.

Summary of Issues. This case shows how the nature of related-party transactions, as practiced by a variety of J-REITs, is reflected in the value per unit held by unitholders. Although a thorough discussion of the appropriateness of the real estate dealings and third-party allotment of units in this case is beyond the scope of this paper, the facts described give rise to questions related to the degree of protection of unitholders' interests.

The sponsor in this case could practically set both the selling prices as well as the purchasing price of the traded properties without needing approval from the supposed owners of the J-REIT, the unitholders. Signs in this case suggest that the prices were set at the disadvantage of unitholders. The same holds for the issue price of the new units, which were solely allotted to the sponsor. Without unitholders' approval for these types of related-party transactions, the sponsor has the ability to act in its own interests. In this case Mori Building, the sponsor, had significant control because it had 100 percent control over the asset management firm, as well as through interlocking directorates with the listed J-REIT. Therefore, considerable room for improvement exists in relation to investor protection measures against abusive related-party transactions.

Section 5: Recommendations for Existing REIT Structures

Many governance issues arise with externally managed REITs because of the inherent principal-agent conflict between external management (agent) and the unitholders of the REIT (principal). REITs structured as trusts are governed differently from companies, and consequently, the governance practices and basic shareholder rights that apply in a corporate structure sometimes do not apply in a REIT.

In this section, we assume that the external management structure cannot be changed. Therefore, the aim of these recommendations is to provide practical and straightforward ways to improve the current governance practices in REITs in the short term. In Section 6, we outline key characteristics of an ideal REIT governance structure from a longer-term view.

Appendix B provides information about REITs in Hong Kong and a sample of REITs in Singapore, Australia, and Japan.⁵⁷ We provide a summary of the fees paid by REITs; unitholder information; the identity of the manager, sponsor, and substantial unitholders; and information on the REIT manager's board of directors. The tables in Appendix B will be referred to in this section.

Board Independence of the REIT Manager

Recommendation. *Governance requirements for the REIT manager's board of directors should be included in the licensing requirements for managers. The board's role should be to provide independent review and oversight over the REIT manager and the operations of the REIT.*

- The REIT manager's board of directors should be majority independent, where the definition of independence excludes management, sponsors, and substantial unitholders.
- The role of the chairman should not only be separate from that of the CEO but also independent of management, sponsors, and substantial unitholders.
- Cross directorships that have the potential to cause a conflict of interest should not be permitted.

This recommendation applies to all externally managed REITs regardless of whether the structure is a manager/trustee or a single responsible entity. In Japan, REIT boards outsource asset management duties to external managers. Although REIT governance and all decisions should be made at the REIT board level, often they are not. In practice, the board of the REIT manager of a J-REIT has substantial control. Therefore, this discussion in regards to a REIT manager is in principal also applicable to the J-REITs.

In externally managed REITs, the REIT manager is a separate company and it is often owned by the REIT sponsor (see [Appendix B](#)). The manager in all jurisdictions has a board that oversees the manager and is responsible for maintaining its overall governance standards.

In all jurisdictions, the management companies are licensed by the appropriate regulator. This rule is designed to ensure that the manager has the capabilities and the experience to function as a manager of assets. Licensing requirements apply to the amount of base capital the manager needs to maintain, what activities they can and cannot undertake, and requirements (if any) imposed on the board.

No requirement exists for the manager to be listed, so often the manager does not have to adhere to any formal governance standards unless stipulated in the licensing agreement. When the manager is wholly owned by the listed entity, the codes and standards applicable to the parent company are also applicable to the manager. Given the nature of externally managed REITs, the potential for conflicts of interest is generally greater than for listed companies. Therefore, REIT managers' compliance with governance codes for listed companies may not be sufficient to protect unitholders' interests.

⁵⁷Not all the information could be gathered for the J-REITs because it was either not relevant or was not available.

In Singapore, the MAS's Licensing Guidelines state that licensed management companies that manage REITs listed on the SGX are expected to abide by the Code of Corporate Governance.⁵⁸ In Australia, all listed entities need to disclose the extent to which they follow the recommendations set out by the ASX Corporate Governance Council, and the listed REITs generally report the governance practices of the RE.⁵⁹

Independent Board. The external structure presents significant conflicts of interests between the sponsor/manager and the unitholders. In this situation, the composition of the manager's board and the independence of the directors are extremely important to manage the conflict of interest and ensure that the manager is performing its duties despite the strong links to the sponsor.

In Singapore, the Code of Corporate Governance requires one-third of the board to be independent;⁶⁰ in Australia, a majority independent board is recommended;⁶¹ and in Japan, supervisory directors must exceed the number of executive directors by at least one.⁶² Based on our sample of REITs in each region, all REIT managers comply (see Appendix B). Requirements in codes and listing rules have no legal basis, and the consequence of noncompliance is not burdensome. Australia is the only market where there is a statutory requirement for an independent compliance committee if the board is not majority independent.

The Hong Kong Code of Corporate Governance requires at least three independent directors for listed companies. Collective investment schemes, however, are not required to follow these guidelines, and there are no requirements for independent directors in the SFC licensing guidelines. Regardless, all of the Hong Kong REIT managers have exactly three independent non-executive directors on their boards and so comply with the code (refer to Table 1, Appendix B).⁶³

Irrespective of the REIT manager's compliance, given that the sponsor has complete control over the nomination and appointment of directors, it is difficult to assess the "true" independence of these directors.

Competing interests between the sponsor and the REIT are accentuated when there are overlapping directorships and directors sit on the board of the sponsor and the REIT manager. This situation can also be a problem when the same director sits on multiple boards of different REIT managers owned by the same sponsor or holding company.

To illustrate the lack of true independence and overlapping directorships, consider the case of ARA Asset Management Limited (ARA), a Singapore-listed real estate funds management company. ARA manages several REITs in Hong Kong (Prosperity REIT, Fortune REIT), Singapore (Fortune REIT, Suntec REIT, CACHE Logistics REIT), and Malaysia (AmFIRST REIT). Each is managed by its own manager, which is a wholly owned subsidiary of ARA.

For example, Fortune REIT is managed by ARA Asset Management (Fortune) Limited (Fortune), Prosperity REIT is managed by ARA Asset Management (Prosperity) Limited (Prosperity), and both are wholly owned by ARA. All three companies have different boards. John Lim, the group CEO of ARA and majority unitholder with 36.8 percent, is a director on all three boards. Justin Chiu is the non-executive chairman of all three and is an executive director at Cheung Kong Holdings Limited, a unitholder (15.6 percent) and affiliate of ARA, as well as the sponsor for both Fortune REIT and Prosperity REIT.⁶⁴ Interestingly, one member who sits on the boards of Fortune and Prosperity is described in her biography as an independent non-executive director (INED). Her biography also clearly states that she is an INED of Cheung Kong Infrastructure Holdings Limited, a listed affiliate of Cheung Kong.

⁵⁸See MAS, Section 8.5, in *Securities and Futures Act (CAP. 289): Guidelines on Criteria for the Grant of a Capital Markets Services Licence and Representative's Licence* (1 October 2002, updated 14 May 2010):11 (www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/Licensing_Guidelines_may_2010.pdf).

⁵⁹See the ASX Listing Rule 4.10.3.

⁶⁰See the MAS, Guideline 2.1, in *Code of Corporate Governance* (July 2005).

⁶¹See the ASX Corporate Governance Council, Recommendation 2.1, in *Corporate Governance Principles and Recommendations with 2010 Amendments*, 2nd ed. (August 2007): www.asx.com.au/about/pdf/cg_principles_recommendations_with_2010_amendments.pdf.

⁶²See Article 95, in *Act on Investment Trusts and Investment Corporations* (Japan).

⁶³The exception is The Link REIT, which has nine or 81 percent independent nonexecutive directors on its board. The Link REIT is an internally managed REIT.

⁶⁴See www.ara-asia.com/home/corp/shareholding.html for more information.

The Centro case outlined in Section 4 also shows how conflicts of interests arise when the REIT manager's board of directors is identical to the board of directors of the majority unitholder and sponsor of the REIT.

Independent Chairman. The chairman has many important responsibilities, including setting the agenda, leading the board discussion, facilitating contributions from all directors, especially INEDs, and promoting high standards of governance. Clear delineation between the roles of CEO and chairman is also important to minimize conflicts of interest, and it gives the board greater ability for independent decision making.

In our sample, there was a clear separation between the roles of CEO and chairman in all REITs. Given the sponsor's ability to appoint directors and its relationship with the REIT manager, however, separation of the roles may not be enough to ensure independent decision making at the board level. In our sample, many of the managers' chairmen also were connected to the sponsor/substantial unitholder. This situation was especially true in Hong Kong, where the chairman of the manager also often holds the position of chair/vice chair at the sponsor and the sponsor is the controlling unitholder of the REIT.

For example, at both Champion REIT and Regal REIT in Hong Kong, the managers are wholly owned subsidiaries of their sponsors. In turn the chairmen/founders of the sponsors are also the largest substantial unitholders of their REITs. Lo Ka Shui, the chairman/founder and managing director of Great Eagle Holdings (Champion REIT sponsor), holds 63.6 percent of Champion REIT, and Lo Yuk Sui, the chairman/CEO and son of the founder of Regal Hotels International Holdings (Regal REIT sponsor), holds 74.5 percent of Regal REIT. Both men are also the chairman of the REITs. **Table 6** shows the details and Table 1 in Appendix B provides more information.

| | Champion REIT | Regal REIT |
|--|---|--|
| Manager | Eagle Asset Management (CP) Ltd | Regal Portfolio Management Ltd |
| REIT Sponsor | Great Eagle Holdings Ltd | Regal Hotels International Holdings Ltd (RHIHL) |
| Largest Substantial Unitholder of the REIT | Lo Ka Shui, chairman, founder, and managing director of Great Eagle Holdings Ltd (63.57%) | Lo Yuk Sui, chairman, son of the founder, and CEO of RHIHL (74.5%) |
| Chairman of the REIT | Lo Ka Shui | Lo Yuk Sui |

Source: Data from Table 1, Appendix B.

An independent chairman is only recommended in Australia, and as a result, it is the only country in our sample where independent chairmen are more prevalent.

Annual General Meetings (AGMs)

Recommendation. *AGMs should be mandatory for all REITs.*

The board and management team of the REIT manager and the trustee should be present at the AGM. Unitholders need to have the right to meet the people managing their investments and question their decisions to ensure that managers are managing the REIT in their best interests. An annual meeting increases the manager's accountability to unitholders and provides an opportunity to update investors on the performance and strategy of the REIT.

Companies are generally required to hold AGMs as a forum for company management and the board to provide shareholders with information on the company's performance, operations, and strategies. It is also an important avenue for shareholders to voice their opinions and views about how the company is performing and to question management and the board.

REITs that are structured as trusts are not governed by Companies Law because of their trust structure. Therefore, REITs are often not required to hold regular AGMs. Instead, REITs usually only need to conduct general meetings when member approval is required on various matters, such as changes to the trust deed, issuance of new units, and acquisitions. These member meetings are usually organized as extraordinary general meetings (EGMs).

For example in Hong Kong and Australia, no requirements exist for REITs to hold AGMs. Despite not being mandated in the Corporations Act or the listing rules, however, the ASX Corporate Governance Council in Australia recommends that “companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.”⁶⁵

There also are no formal requirements for J-REITs to hold regular AGMs. Rather, REITs only have to hold general meetings once every two years in part because directors can only serve for a maximum two-year term, for which unitholder approval is required. Regardless of the fact that they are not mandated, with the exception of the J-REITs, all REITs in our sample still hold annual unitholder meetings and EGMs when they are necessary.

The MAS in Singapore recently amended the Property Fund Guidelines to mandate that REITs hold AGMs. The MAS initially proposed AGMs for REITs in June 2005, but the prevalent view in the market at that time was that it was appropriate to just allow EGMs to be convened at the request of an appropriate number of participants. It revisited the issue in May 2009, and after receiving positive feedback from the market, effective 1 January 2010 all REITs must hold AGMs once every calendar year and not more than 15 months apart. The MAS stated two main reasons for its decision. The first was to maintain consistency of standards between listed public companies and international best practices. The second was to increase the flexibility for REITs, especially when they need to obtain or renew general mandates from unitholders on the issue of new units.

Ownership Structure and Related-Party Transactions (RPTs)

Recommendation. *The identities and level of ownership of related parties who have substantial unitholdings should be disclosed, and material RPTs should be reviewed by independent experts, disclosed to the local stock exchange, and approved by independent directors and independent unitholders.*⁶⁶

As best practice, all REITs (including the REIT manager) should adopt a written “Conflict of Interest and Related-Party Transactions Policy” wherein they define “related party,” express why they may need to engage with related parties, and outline their internal control procedures in dealing with conflict of interest situations and RPTs.

RPTs (that reach the approval and disclosure thresholds) should be:

1. Reviewed by an independent adviser to ensure that only fair-market valuations are applied;
2. Approved by “disinterested” directors when board approval is required;
3. Disclosed to investors in a timely manner through an announcement to the local stock exchange; and
4. Approved (if material) by unitholders in a vote by poll with related parties abstaining from the vote.

A common feature in many Asian REITs is that the sponsors often hold significant stakes in the underlying REITs. The stakes can be held directly or indirectly through subsidiaries and affiliated companies and can be large. For example the average unitholding of sponsors’ in underlying REITs in Hong Kong is approximately 40 percent. Sponsors and managers are often also connected, in that managers are wholly owned (directly or indirectly) or affiliates of the sponsors. The same is often true for the property managers.

⁶⁵ ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations with 2010 Amendments*, 2nd ed. (August 2007):11 (www.asx.com.au/about/pdf/cg_principles_recommendations_with_2010_amendments.pdf).

⁶⁶ For more information on the position of CFA Institute on RPTs, please refer to Lee Kha Loon, CFA, and Abe De Ramos, “Related Party Transactions: Cautionary Tales for Investors in Asia” (January 2009): www.cfapubs.org/doi/pdf/10.2469/ccb.v2009.n1.1.

These interconnected structures make related-party transactions almost inevitable. Problems arise when various parties start to abuse the nature of RPTs and use these transactions as a way of expropriating wealth from minority unitholders. A good example for REITs is the transfer of assets between connected parties, often from unlisted vehicles to listed vehicles and often at inflated prices. The problem is further compounded when the sponsors (often majority unitholders) hold numerous positions on the boards, including chairman, so that there is no separation of ownership and control of the REIT.

A recent example of an RPT is the Fortune REIT case described in Section 4. In that case, the sponsor, who also was the majority owner of the REIT and an indirect co-owner of the manager, was a connected party in a transaction under which three properties were sold to the REIT.

The ownership structure cannot be changed, but large unitholdings by connected parties should be disclosed in the annual reports. This approach is already practiced in Hong Kong, Singapore, and Australia, although it is not as common in Japan. Identifying substantial unitholders in annual reports and exchange releases is difficult. REITs should voluntarily disclose the identities and level of ownership of related parties who own a substantial amount of their shares, including holdings of subsidiaries and affiliated companies. This will also help to ensure that “interested” parties can be identified and, where appropriate, abstain from voting in certain transactions.

It is important to have appropriate checks and balances in place to prevent abusive RPTs from occurring. All jurisdictions have RPT regulations in place. In Hong Kong and Singapore it is included in the REIT Code, whereas in Japan it is covered in the ITL, and in Australia it is covered in the Corporations Act.

Independent Valuation and Opinion. One of the more important checks is an independent valuation of the properties being sold or acquired. Singapore and Hong Kong both have requirements for independent valuations incorporated into their REIT codes. The requirements specify the number of independent valuations needed as well as the specific criteria the valuers are required to meet in terms of independence, experience, and qualifications. The valuers need to prove they are independent of the schemes, trustees, managers, and other significant holders of the schemes. Often a separate opinion letter is also prepared by an independent expert stating whether the transaction is fair and reasonable to investors.

Disclosure and Approval. Valuation reports and independent expert reports are also required to be disclosed in the circulars to the exchange that outline the details of RPTs. Hong Kong and Singapore set threshold limits, and any transactions over the threshold need immediate disclosure to relevant exchanges and/or unitholder approval. Regulations do not stipulate any thresholds for disclosure or investor approval in Australia; disclosure of material transactions is made on a continuous basis. In Japan, asset management companies are responsible for disclosing information on RPTs, and REITs are obliged to provide reports detailing the related-party transactions with sponsors.

As part of their monitoring duties, trustees in Hong Kong and Singapore and RE boards in Australia also have to approve such transactions. In Japan, typical RPTs between the sponsors and REITs do not need approval from J-REIT boards. As long as asset management company boards approve the deals, that is all that is necessary.

The final hurdle for RPT approval is a unitholder vote. To improve investor protection against RPTs, material transactions—specifically those that involve the transfer of assets and those that could lead to the dilution of minority stakeholders—should be subject to unitholder approval in a voting by poll, with the related parties abstaining from the vote. RPTs in Hong Kong, Singapore, and Australia, but not Japan, have to go to unitholders for approval and interested parties are not allowed to vote.

Manager Entrenchment

Recommendation. *Trust deeds/management agreements should not contain clauses that in any way entrench the manager or limit unitholders' rights.*

If any such clause is included at IPO, it must be clearly disclosed in the offer document. If introduced after listing, any such clause must be subject to unitholder approval. This approach will allow the market for corporate control to function effectively, and unitholders' rights will not be compromised because they will have the ability to exercise their right to vote out management.

Management rights to the REIT are extremely valuable to the manager because they provide a large, steady, and perpetual income stream in the form of fees. To preserve the income stream, managers often find ways to entrench themselves in the business so that they are difficult to remove or, if they are removed, they are still entitled to the management fee.

There are three ways in which managers can entrench themselves in the REIT.

Captive REITs. As discussed in the previous section, sponsors (who often own the managers) have key stakes in REITs that can act as anti-takeover defenses. The direct holdings give sponsors the right to vote on resolutions and, therefore, use their “muscle” to pass resolutions that are in their best interests. Given that they can effectively control the REITs through such block holdings and through the boards, they can make it almost impossible for third parties to gain acceptance for successful takeovers.

Pre-Emptive Rights. Managers can also include provisions in management agreements that essentially embed current managers so that management fees are secured. Pre-emptive rights also deter bidders interested in acquiring such REITs for the management rights.

Pre-emptive rights are often in place with co-owned assets and can act to protect the beneficial interests of the owners in the event of a change in management or control. This right can be problematic, however, when the pre-emptive rights are held by parties related to the managers or sponsors.

For example in **Figure 18**, Sub A is a subsidiary of the sponsor and a related party to the manager. It has pre-emptive rights on 50 percent of the REIT's assets. Bidder A is attempting a takeover of the REIT with the objective to change the manager. However, if Sub A's right is triggered under a change in control, it can acquire the remaining 50 percent of the REIT's assets it does not already own. In practice, Bidder A will not pursue the takeover and the income stream of the manager and ultimately the sponsor is protected. Similarly, if unitholders attempted to vote out the current manager, this move would also trigger Sub A's right to acquire the REIT's assets.

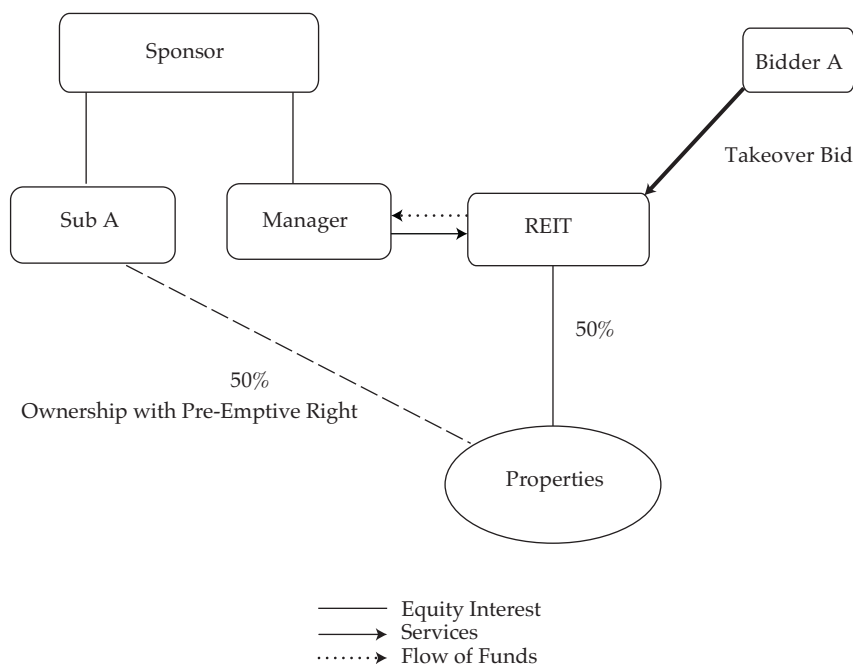
It is clear that pre-emptive provisions that are triggered by a change in control or change in management effectively place the REIT, or more importantly the manager, in an untouchable position in which the management's rights and fee stream are secured at the expense of unitholders. Unitholders are not able to exercise their rights to vote out management, and they will not be able to realize any premium for control because of the anti-takeover defenses in place.

Length of Management Term. Another way to entrench the manager is to impose a long management term with provisions in place that secure the fee income if the manager is removed. An example of this situation occurred in Australia.

APN/UKA European Retail Trust (ASX: AEZ) was initially structured as a trust with an external responsible entity (RE).⁶⁷ The RE delegated the asset management of the trust to a third party, APN/UKA Management Ltd., in which it owned 50 percent. The asset manager was responsible for overseeing the day-to-day management of the properties in the portfolio as well as providing services in relation to acquisition and disposal. The total base management fee paid by the trust was paid to both the RE and the asset manager, such that the RE's share was not to exceed 10

⁶⁷ APN/UKA European Retail Trust, “Product Disclosure Statement” (9 March 2006):136.

Figure 18. Example of a Problematic Pre-Emptive Rights Scenario



percent of the total base management fee and the asset manager's share was not to exceed 90 percent of the total base management fee. The asset manager was appointed for a term of 20 years with two options to extend for periods of 5 years each. In the asset management agreement, there were provisions that stated if the asset manager was terminated other than by default of its duties, the RE and owners would be liable to pay an early-termination payment to the asset manager representing the value of the base management fee that would have been payable to the asset manager had the agreement not been terminated.

The 20-year management term, together with the early termination/payout clause, had the effect of deterring any takeover attempt. Any change in control would have triggered the early-termination clause and a significant transfer of money to the asset manager and, essentially, the responsible entity. This case illustrates that this is another way the RE can protect its fee income and fend off potential bidders vying for control.

Removing the REIT Manager

Recommendation. *Unitholders should have the right to remove and appoint the REIT manager.*

They should also have the right to call a meeting, put forward a resolution to remove/appoint the manager, and participate in a fair vote on an ordinary resolution to remove or elect a manager.

Given the structure of externally managed REITs, unitholders have an interest in the REITs but not in the managers. Therefore, unitholders have no rights when it comes to appointing directors to the manager's board. Most governance reports state that the appointment of directors to the manager's board is decided by the board and the unitholders of the REIT manager, which is essentially the REIT sponsor. Consequently, boards are usually stacked with representatives of the sponsors and nominating committees are rare.

Although unitholders do not have rights to appoint or remove directors, they should have rights to remove managers. Unitholders are dependent on managers to operate in a way that maximizes unitholder value. For this reason, unitholders need to be able to vote out underperforming managers and replace them. It is also important that the thresholds required to call meetings or

put forward resolutions are not so high that they act as another method to entrench the manager. Investors need to be given genuine opportunities to exercise their rights; whether they actually choose to exercise those rights is their choice.

In Japan, the corporate structure of J-REITs affords investors similar voting rights at general meetings as those that are afforded to other companies in Japan. Under these rules, unitholders are able to appoint corporate and supervisory officers (equivalent to independent directors) to their boards. Consequently, investors have two lines of defense: They can remove directors from the investment corporation, or they can call a meeting to remove the asset manager. Investors have the ability to remove directors with a simple majority of votes present at unitholders meetings. Also by a simple majority, investors can approve resolutions to cancel contracts for asset managers.

Focusing on the countries of Australia, Hong Kong, Japan, and Singapore, investors need to be able to:

1. Call a meeting. In all four markets, unitholders have the right to requisition a members' meeting. The voting interest required to call a meeting varies across the jurisdictions, ranging from 3 percent in Japan to 10 percent in Hong Kong and Singapore. In Australia, the RE is responsible for calling the meetings and for the expenses associated with calling and holding such meetings.
2. Put forward a resolution to remove the manager. It appears that only in Australia are unitholders able to put forward resolutions to remove managers/responsible entities. Responsible entities are then required to give all members of the scheme notice of such resolutions. Regulations in Hong Kong, Japan, and Singapore are unclear on this issue.
3. Participate in a fair vote to pass an ordinary resolution. Unitholders in all jurisdictions have the right to vote on the removal of managers through an ordinary resolution. In June 2010, Hong Kong lowered the threshold from 75 percent of units in value to a simple majority of all votes present (in person or proxy) and entitled to vote. Previously, votes excluded units held or deemed to be held by the management companies, as well as holders who may have had interests in retaining the management companies, including directors, associates, and any controlling entity.⁶⁸

Management Fee Structure

Recommendation. *A fee structure needs to be established that aligns the interests of unitholders with those of the manager.*

Performance fees should be structured in a way that managers are rewarded for good performance and penalized for poor performance. Making fees contingent on actual performance, such as relative share price performance or distribution per unit (DPU), will better align interests and decrease potential agency problems.

In the case of external management, determination of how fees are structured between the different parties is very important to the net return of unitholders. The most common fees paid by REITs include the REIT managers' fees, acquisition/disposal fees, property management fees, and trustee fees. Apart from the trustee fees, often the ultimate beneficiaries of fee income paid by REITs are the REIT sponsors.

The REIT manager's fee can take many forms, but the most common is based on a base fee and a performance fee that together make up the manager's total management fee. It is common practice in Australia, Hong Kong, and Singapore for the base fee to be based on a percentage of the value of the properties managed. In our sample of various REITs, such fees can range from 0.1 percent to 0.6 percent (see Appendix B). A-REITs pay fees at the upper end of this range, likely because they also act as asset custodians and, therefore, do not pay additional trustee fees. In Japan, base fees can be based on a range of metrics, including percentage of rental income, cash flow, or asset base.

⁶⁸See Section 5.14c, in "Code on Real Estate Investment Trusts" (June 2010 and June 2005). The commission's rationale for the change in the June 2010 consultation was to allow all unitholders to vote on the appointment and removal of REIT managers because it would better align the economic interests of controlling stake of ownership in a REIT and is in line with regulations in other comparable international markets such as Australia and Singapore. See section 52 of SFC's Consultation Conclusions (June 2010):11 (www.sfc.hk/sfc/doc/EN/speeches/public/consult/REIT_Consultation_Conclusions_Jun2010.pdf).

Performance fees are the most problematic for unitholders. Although they can be based on different metrics, performance fees are often based on net property income. Two potential flaws, however, exist in this form of compensation. First, the fees are not linked to net income net of borrowing costs, and second, the fees are not linked to managers' actual performance.

Under such compensation structures, a REIT could be growing the net income base, but distributable income may not be growing at the same rate because of higher net borrowing costs. This situation can lead to a REIT's overall performance being poor but the fee to the manager still being large. Therefore, no disincentive exists for managers with poor performance, and there is no incentive to find a favorable rate on debt.

Performance fees can be compared with incentive bonuses for company executives and thus should be linked to performance measures that reflect growth in unitholder value. In this way, managers will be rewarded for good performance and penalized for poor performance. Fee structures need to be set in a manner that best aligns the interests of unitholders with those of the managers.

An example would be to link the performance fee to growth in distributions per unit, as is the case with Ascendas REIT in Singapore. An incentive fee calculated on the basis of distributions per unit not only better aligns managers' compensation to something that is tangible to unitholders—their distribution—it also is calculated on a per unit measure so managers can take into account growth in the underlying unitholder base. Therefore, they are not rewarding themselves for dilution.

Another example common in Australia is when performance fees are only payable when the REIT outperforms a sector-based stock index over a given period, with fee scales that escalate according to the level of outperformance. When the REIT underperforms, the underperformance needs to be earned back before any performance fee is payable to the RE. See [Table 7](#) for examples of performance fees in Singapore and Australia.

| REIT | Performance Fee Definition |
|---|---|
| Ascendas REIT (Singapore) | 0.1 percent per year of the deposited property, provided that the growth in distributions per unit (DPU) in a given financial year (calculated before accounting for the performance fee in that financial year) exceeds 2.5 percent; and an additional 0.1 percent per year of the deposited property, provided that the DPU growth exceeds 5 percent. |
| Commonwealth Property Office Fund (Australia) | Only payable if the fund's total return (distributions and capital growth) exceeds the S&P/ASX 200 Commercial Property Accumulation Index (excluding CPA). The fee is 5 percent of the gross asset value for the first 1 percent of outperformance and 15 percent for outperformance in excess of 1 percent. Any underperformance needs to be earned back before the RE can earn performance units. The fee is capped at 0.15 percent of the fund's gross asset value per 6-month period. |

Source: Data from Table 2, Appendix B.

In addition to the management fee, managers are often paid acquisition and disposal fees, which are based on a specified percentage of the purchase or sale price. Although a certain amount of asset turnover is appropriate within the REIT's portfolio of assets, these types of transaction-based fees have the potential to encourage managers to "trade" the portfolio. They essentially give a green light to grow the asset base, potentially at the expense of unitholder value. If managers then use debt to finance acquisitions, the problem can be compounded, especially if performance fees do not take into account the cost of debt. Managers should be rewarded for active management decisions, not just asset growth.

Gearing Restrictions

Recommendation. *No need exists for leverage restrictions in regulations as long as proper governance practices are in place and the rights of unitholders are not compromised.*

Decisions to use debt funding should remain business decisions. To improve transparency, REITs should provide adequate disclosure of relevant information about debt covenants and debt restrictions imposed in their trust deeds.

Gearing restrictions on REITs vary around the world. Of the Asia-Pacific countries that have restrictions, leverage is usually capped at around 50 percent of total assets. Thailand restricts any form of borrowing, whereas by contrast, Australia, New Zealand, and Japan have no restrictions on leverage at all.

The two largest REIT markets in the world—the United States and Australia—do not have gearing restrictions. Nevertheless, average gearing is not excessively high, at 55 percent in the United States and 35 percent in Australia.⁶⁹ In the four markets in our study, only Hong Kong and Singapore have such restrictions (see Appendix A).

The most obvious reason for imposing gearing restrictions is to protect unitholders from managers taking on excessive debt levels, especially when markets are experiencing significant growth. There are several sensible reasons, however, why leverage restrictions do not work in the way they are intended.

Reduced Competitiveness of REITs. Organic growth is limited in REITs because they need to payout most, if not all, of their net earnings as distributions to unitholders. Instead, REITs are limited to the capital markets for funding and, consequently, need to decide between debt and equity. Such choices will depend on market conditions.

For example, in times when interest rates are low, debt funding will be preferable to equity funding because it will lower the overall cost of capital. In this situation, gearing restrictions will limit the REIT's ability to fund acquisitions with the most competitively priced capital. If a REIT cannot tap the debt market to fund expansion, it will be forced to go to the equity market to raise capital despite being the suboptimal choice. Given that the market is aware of the restrictions, investors will anticipate equity raisings from REITs that are close to their thresholds, thus leading to a weakening share price.

Not only will leverage restrictions make project financing more expensive, but they also may limit the number of value-enhancing growth opportunities available for REITs because of the higher project hurdle rates.

Business Decision or Regulator Decision? Companies do not have restrictions on the amount of leverage they use to finance their investments, so why should REITs be different? The capital structure of a REIT should be a business decision because company directors and executive management are responsible for managing leverage limits. Irrespective of whether regulators impose restrictions on debt or not, when banks provide financing to REITs (and companies), several covenants are set up to protect the interests of debt holders. Restrictions on the amount that REITs can borrow are often also contained in trust deeds or trust constitutions for the benefit of protecting the interests of unitholders.

⁶⁹Ernst & Young, “Global Real Estate Investment Trust Report 2010: Against All Odds” (2010):22 ([www.ey.com/Publication/vwLUAssets/Global-REIT-report-2010-Against-all-odds/\\$FILE/Global_REIT_report_2010_Against_all_odds.pdf](http://www.ey.com/Publication/vwLUAssets/Global-REIT-report-2010-Against-all-odds/$FILE/Global_REIT_report_2010_Against_all_odds.pdf)).

REIT Governance

Recommendation. *Given the trust structure of REITs in Hong Kong, Singapore, and Australia, the best governance structure to minimize conflicts of interest between managers and unitholders and improve oversight is the single responsible entity.*

Under this structure, only one responsible entity is accountable to investors. The single responsible entity is responsible for holding the assets in custody for unitholders and for the independent oversight of the REIT. Confusion around the roles and responsibilities of trustees is removed and replaced with independent boards and/or independent compliance committees.

Three main governance structures exist within the four markets considered in this study. REITs in Hong Kong, Singapore, and Australia all have trust structures, although fund management responsibilities differ in each. Trusts in Hong Kong and Singapore operate a dual-party system and thus have separate managers and trustees. Trusts in Australia, however, have responsible entities. In Japan, listed J-REITs are investment corporations that are not trusts. For more information, see Section 3 on the individual REIT markets.

With the exception of The Link REIT in Hong Kong and the stapled structures in Australia, all listed REITs in Singapore, Hong Kong, Japan, and Australia are externally managed.

The nature of REITs is to separate the ownership and control of the underlying pooled assets. A professional management team controls the investor's pooled assets, and the beneficial owner, the unitholder, has a passive investment. This structure potentially creates conflicts of interests between the interests of investors and the interests of insiders. Even though managers have a fiduciary duty to act in the best interests of investors, the separation of ownership and control increases the risk that managers or related parties will use the assets for their own financial gain and at the expense of unitholders. This risk could manifest in various ways. For example, a sponsor could sell an asset to the REIT at an inflated price, and thus engage in asset swapping between related parties for the benefit of a privately owned, related company. As a consequence, it is important for REITs to have robust governance structures in place to minimize the risk of expropriation by insiders.

As discussed by the International Organization of Securities Commission (IOSCO), the governance of Collective Investment Schemes (CIS), REITs should ensure that they are organized and operated in the interests of REIT investors and not for the interests of REIT insiders, such as managers and sponsors. One of IOSCO's primary principles for CIS governance is that "Independent Entities" are the primary source of independent review and oversight.⁷⁰

The key independent entities for REIT governance in each structure are listed below:

- Trust structure (Hong Kong and Singapore)—Trustee (and board of REIT manager)
- Trust structure (Australia)—Independent directors or compliance committees of the REs
- Investment Corporation (Japan)—Board of directors

Although the independent entities are different depending on the legal structure of the REITs, their roles are the same—they should provide independent oversight and limit conflicts of interests between the operations of the REITs and their ultimate owners.

In the case of Japan and Australia, ensuring independence of REIT boards and REs is key. In the case of Hong Kong and Singapore, this oversight can only be achieved if trustees actually provide independent review and oversight over the manager. In practice, trustees mainly act as custodians and, therefore, conduct more "tick-the-box" compliance on behalf of unitholders rather than true oversight. Trustees are usually passive and do not interfere in the management of REITs, nor have they been known to intervene on investors' behalf.

This difficulty in oversight was one of the reasons Australia moved away from the dual-party system of funds management. The dual system was set up because trustees should ideally supervise the activities of the managers. Not only are they the custodians of the trusts' assets for

⁷⁰ Please refer to IOSCO, "Examination of Governance for Collective Investment Schemes, Part II" (February 2007): www.iosco.org/library/pubdocs/pdf/IOSCOPD237.pdf.

the benefit of investors, but they are responsible for monitoring whether the managers are managing the REITs in accordance with the trust deeds and relevant regulations.

Understanding the delineation between the responsibilities of the managers and trustees, however, was hard in practice. It left investors confused as to which party was ultimately accountable, which is a major issue if something goes wrong. Under current regulations, the single responsible entity is ultimately responsible for the trust's assets, and increased statutory requirements imposed on the RE, such as independent boards, compliance committees, and so on (see Section 3), strengthen their ability to conduct independent oversight.

The investment corporation in Japan acts in a similar way to the single responsible entity because it has the ability to outsource the management and custodianship functions. The board of directors of such corporations, however, is ultimately responsible for the best interests of investors.

Single Responsible Entity. There were several different inquiries and reviews conducted in Australia when the single responsible entity was introduced by the MIA. To date, a debate continues about which structure is ultimately better at protecting investors' interests.

Using Australia's recent experience as an example, some of the key reasons for and against a single RE are outlined in **Table 8**.

| For | Against |
|--|--|
| One single entity that carries FULL responsibility for assets and liability for losses. | No mandatory third-party custodianship of scheme assets. |
| Increased investor protection through mandatory compliance arrangements (compliance plan, compliance committee, etc.) and increased protection against RPTs. | Scheme is not subject to real-time monitoring. |
| Increased statutory requirements for the RE. | Potential for lower compensation if fund is wound up because of lower capitalization of RE versus a trustee. |
| RE must be licensed, and the scheme must be registered by the regulator. | Increased conflict of interest. |

The two main areas of contention were that under the MIA, there was no provision for mandatory third-party custodians and the RE model does not provide real-time monitoring. The segregation of the custodial arrangements from the manager is seen as best practice internationally and is recognized in IOSCO's principle as an important practice for all CIS. The MIA does not mandate this approach but permits the RE to hold the assets itself, outsource the duty to a legally or commercially related entity, or outsource to an independent third-party custodian.

A study carried out in 2003 found that although there was no statutory requirement, 78 percent of all property-related schemes, of which more than 90 percent were REITs, used external independent custodians.⁷¹ The finding may have been because REITs did not have the capacity to satisfy the ASIC criteria for self custody as a result of commercial or prudential reasons. In terms of oversight, the MIA has put in place several new statutory requirements for an RE: It must have a compliance committee if less than a majority of the RE board is independent, and it must put together compliance plans that are audited annually by independent auditors.

Singapore introduced a similar regime in 2003, called "Business Trusts." Unlike REITs that are CIS governed under the Securities and Futures Acts, business trusts are subject to regulations in the Business Trust Act (BTA). When business trusts invest in real estate, they are not restricted to just passive investments in real estate but can undertake property development.

There are similarities between the Australian managed investment scheme regime and business trusts. The rationale for a trustee-manager was because the business trust would be actively undertaking business operations and, therefore, it would be difficult for an independent trustee to properly understand and monitor the manager's business decisions. Similar to Australia, the BTA imposes several governance measures on the trustee-manager, including increased statutory duties of the trustee-manager to avoid conflicts of interest, increased independence of the board of directors, and disclosure of governance practices.

⁷¹ Grant Moodie and Ian Ramsay, "Managed Investment Schemes: An Industry Report." Centre for Corporate Law and Securities Regulation, University of Melbourne (2003):36 (<http://cclsr.law.unimelb.edu.au/research-papers/Monograph%20Series/Managed%20Investments%20.pdf>).

Section 6: Recommendations for an Ideal REIT Governance Structure

This section describes the governance characteristics of a model REIT structure that we believe minimizes conflicts of interests between the manager and unitholders, properly incentivizes management, and upholds good REIT governance standards. These recommendations are designed to help the new and developing REIT markets and guide long-term changes in existing markets.

These recommendations include some of the recommendations outlined in Section 5 but also include additional recommendations that would not be easy to implement in the current structure, although they would improve current REIT governance standards.

Characteristics of an Ideal REIT Governance Structure

Internalized Management

Recommendation. An internal management structure better aligns the interests of the manager with those of the unitholders.

- When a REIT wholly owns the manager, so that employees of the manager are now employees of the REIT, conflicts of interest between unitholders and the manager are reduced.
- The management team is independent from the REIT sponsor.
- A trust structure cannot have any employees, so an internalized management structure suggests the corporate structure is most appropriate. This structure is only feasible for REITs if a tax-exempt corporate structure is possible under the various tax laws.⁷²

Board of Directors

Recommendation. The REIT has its own independent board of directors, and unitholders can appoint or remove directors.

- The board should oversee management and review all major financial decisions. It would monitor the performance of the manager and ensure the manager is carrying out its duties in the best interests of unitholders.
- The board should consist of majority independent directors and an independent chairman.
- Unitholders should have the right to nominate, appoint, and remove directors. The thresholds for approval should not be overly burdensome so to restrict unitholders' voting rights.

Annual General Meetings (AGMs)

Recommendation. AGMs should be mandatory for all REITs.

Unitholders need to have the right to meet the people managing their investments and question their decisions to ensure that they are managing the REIT in the unitholders' best interests. An annual meeting increases management's accountability to unitholders and provides an opportunity to update investors on the performance and strategy of the REIT.

Approvals for Related-Party Transactions (RPTs)

Recommendation. Material RPTs should be reviewed by independent experts, disclosed to the local stock exchange, and approved by independent directors and independent unitholders.

As best practice, REITs should adopt a written "Conflict of Interest and Related-Party Transactions Policy" wherein they define "related party," express why they may need to engage with related parties, and outline their internal-control procedures for dealing with conflict of interest situations and RPTs.

⁷²Discussion of tax effective structures is beyond the scope of this report.

RPTs (that reach the approval and disclosure thresholds) should be:

1. Reviewed by an independent adviser to ensure that only fair-market valuations are applied;
2. Approved by “disinterested” directors when board approval is required;
3. Disclosed to investors in a timely manner through an announcement to the local stock exchange; and
4. Approved (if material) by unitholders in a vote by poll with related parties abstaining from the vote.

Remuneration

Recommendation. In an internally managed structure, the management team should receive salaries, making managers’ fees irrelevant.

It is important to have a remuneration committee with a minimum of three directors, a majority of whom are independent. This structure will help ensure management is paid salaries and incentives that are commensurate with their responsibilities and performance. Remuneration policies and a detailed remuneration report should also be disclosed to investors.

Gearing Restrictions

Recommendation. No regulatory need exists for leverage restrictions as long as proper governance practices are in place and the rights of unitholders are not compromised.

The decision to use debt funding should be a business decision. Increased disclosure about debt covenants and debt restrictions imposed in the trust deed will facilitate transparency and improve investor protection.

Controlling Unitholder Should Not Own More Than 50 Percent of the Issued Units

Recommendation. A unitholding restriction of 50 percent would not only improve REIT governance practices but also improve tax pass-through benefits for investors.

A public float of at least 50 percent can help eliminate potential conflicts of interest between the controlling unitholder and other investors. It provides unitholders with the opportunity to exercise their rights without being marginalized by a controlling unitholder. It would also allow a greater number of investors to benefit from the tax benefits of owning a REIT. When the REIT is closely held by the sponsor, the REIT essentially acts as a subsidiary of the sponsor. Consequently, the sponsor is able to keep a majority of the tax incentives available to investors.

Appendix A. REIT Codes and Regulations

| | Australia | Hong Kong | Japan | Singapore | Philippines |
|------------------------------------|---|--|---|--|--|
| First REIT listed | 1971 | 2005 | 2001 | 2002 | NA |
| Date established | No separate REIT regime | 2003 | 2000 | 1999 | 2009 |
| <i>Regulatory framework</i> | | | | | |
| 1. Main regulatory body | ASIC | SFC | FSA | MAS | SEC |
| 2. Main governing law | Chapter 5C of the Corporations Act 2001 and Income Taxation Assessment Acts 1936 and 1997 (ITAA 1936, ITAA 1997), Tax Administration Act 1953 (TAA 1953) | Code on Real Estate Investment Trusts and Securities and Futures Ordinance (SFO) | Financial Instruments and Exchange Law, Investment Trust and Investment Corporation Law | Code on Collective Investment Schemes—Property Fund Guidelines, Securities and Futures Act (SFA) | Republic Act No. 9856 (REIT Law) Implementing Rules and Regulations (IRR) 13 May 2010 |
| 3. Operational rules | To qualify for pass-through taxation the REIT must be a managed investment trust ^a (MIT) as defined in the TAA 1953. | The management company must be licensed under the SFO. | The asset management company must be licensed with the FSA. | Fund must be managed by a certified manager under the SFA. | Must have at least 1,000 public shareholders each owning at least 50 shares of any class and who in aggregate own at least 1/3 of outstanding shares. Paid up capital of 300m pesos. |
| <i>Fund characteristics</i> | | | | | |
| 1. Legal structure | Two common REIT structures <ul style="list-style-type: none"> • Standalone unit trust • Listed stapled security (company and trust) | Unit Trust | Unit Trust or Corporate (all listed on stock exchanges are corporate) | Unit Trust or Corporate (generally trusts in practice) | Corporation |
| 2. Management structure | Internal/External | Internal/External | External | External | External |
| 3. Single responsible entity (RE)? | Yes. RE has ultimate responsibility of the trust. | No. Trustee and manager must be functionally independent of each other. | No. Asset management responsibility rests with external manager of the REIT's assets. | No. Separate trustee and manager. | Not applicable. |

(continued)

| Characteristics | Australia | Hong Kong | Japan | Singapore | Philippines |
|--------------------------------------|--|--|---|---|--|
| 4. Mandatory listing on the exchange | No but it is easier to qualify as "widely held" for the purpose of meeting the MIT requirements | Yes | No | No, but due to tax treatment, all current S-REITs are listed at the SGX | Yes |
| <i>Income and asset requirements</i> | | | | | |
| 1. Percentage of real estate | No specific asset limits for REITs. However, for the trust to be eligible for pass-through taxation it must only invest in "land for the purpose of deriving rent" or other eligible investment activities as classified under Division 6C of ITAA 1936. Otherwise it will be classified as a public trading trust and taxed like a company. | Only allowed to invest in income-generating real estate. It may acquire uncompleted units in a building that is unoccupied and non-income producing in order to redevelop or refurbish, but the contract value should not exceed 10% of the total net asset value. | At least 70% | At least 75% of the fund's deposited property should be invested in income-producing real estate. | At least 75% of deposited property should be invested in income-generating real estate. |
| 2. Property development | No. Property development carried out by the trust will disqualify the trust for pass-through taxation. In a stapled structure the active "trading" business is carried out by the company and the trust is not affected. | Not allowed. | Not allowed to engage in property development activities. | The fund should not undertake property development activities unless the fund intends to hold the developed property upon completion, and the total contract value should not exceed 10% of the portfolio's deposited property value. | No, unless the REIT intends to hold the property for at least 3 years after completion and total contract value cannot exceed 10% of its deposited property. |
| 3. Geographical restrictions | No | No | No | No | No, provided that the investment does not exceed 40% of the deposited property and upon special authority from the SEC. |

(continued)

| Characteristics | Australia | Hong Kong | Japan | Singapore | Philippines |
|----------------------|--|--|---|--|---|
| Leverage | No restrictions unless the listed REIT is either a foreign controlled REIT or the REIT controls a foreign entity. Then gearing level is 75% of the adjusted Australian asset base. | Aggregate borrowing cannot exceed 45% of gross asset value at any time. | No restriction. | 35% of total assets, capped at 60% if REIT is rated, and the credit rating disclosed. | Aggregate borrowing should not exceed 35% of its deposited property. REIT with an investment grade rating by a credit rating agency can borrow up to 70%. |
| Distribution rules | No restrictions for trust or stapled security. Payout ratios are in the trust deed. | At least 90% of annual net income after tax. | At least 90% of taxable income. | At least 90% of taxable income arising from Singapore assets. | At least 90% of net income. |
| <i>Taxation</i> | | | | | |
| 1. Conduit structure | Pass-through taxation | Taxed | Pass-through taxation | Pass-through taxation | Pass-through taxation |
| 2. REIT | REIT is not taxable as long as unitholders are entitled to 100% of net income. The trust will be taxed at the highest marginal tax rate on income that is not assessable to unitholders. | REIT is subject to either property tax or profits tax depending on whether an SPV is holding the assets. | REIT is subject to corporate tax on amount un-allocated to unitholders. | 17% corporate tax on the undistributed taxable income. | REIT is subject to income tax on its net income after the distribution of dividends. |
| 3. Investor | Taxed | Tax exempt | Taxed | Generally exempted from tax, except for foreign corporate unitholders and any individuals deemed to be in a trading business | Generally taxed except for domestic corporations, resident foreign companies, and overseas Filipinos |

(continued)

| Characteristics | Australia | Hong Kong | Japan | Singapore | Philippines |
|---------------------------------------|---|---|---|--|---|
| <i>Governance</i> | | | | | |
| 1. RPT regulations | Yes, member approval is required for any transaction where a financial benefit is given to a related party that comes out of scheme property or could endanger those interests. No thresholds are given. | Unitholders' approval is required when total consideration or value of the transaction (or cumulative value with same person within 12mths) is equal to or greater than 5% of the latest net asset value of the scheme. An ordinary resolution is required for the approval of a connected party transaction. Interested parties shall abstain from voting at the general meeting. | No | a) transaction is equal to or greater than 3% of the property fund's NAV—announce the transaction immediately; or b) transaction is equal to or greater than 5%—announce the transaction immediately and obtain a majority vote at a participants' meeting. Interested parties will not be allowed to vote on the resolution to approve the transaction. | Any contract or amendment between the REIT and related parties needs to be approved by at least a majority of the entire membership of the board of directors including the unanimous vote of all independent directors. No unitholder approval is required. |
| 2. AGMs | No | No | Yes | Yes | Yes |
| 3. Do members have the right to: | | | | | |
| • Vote on the removal of the manager? | Yes, members can call a meeting and put forward an ordinary resolution to remove the manager. The RE and its associates are entitled to vote their interest on an ordinary resolution to remove the RE and chose a new one. | Yes can be removed by the trustee by notice in writing if an ordinary resolution passed by unitholders. All unitholders have the right to vote including the manager and its associates if they are unitholders. | Yes the asset manager can be removed by resolution being adopted at a unitholders' meeting. | Yes, vote by simply majority of participants at AGM, and the manager, its associates, and other interested parties should not vote on the resolution. | Not specified. |

(continued)

| Characteristics | Australia | Hong Kong | Japan | Singapore | Philippines |
|--|--|---|--|--|--|
| <ul style="list-style-type: none"> Call a members' meeting? | Yes, members need at least 5% of votes or at least 100 members to call a meeting. | Yes, two or more holders holding not less than 10% of the outstanding units can call a meeting. | Yes. Unitholders need at least 3% of the votes to call for an extraordinary meeting. | Yes, requested in writing by not less than 50% of the unitholders or participants representing not less than 10% of the issued units of the property fund. | No |
| <ul style="list-style-type: none"> Put forward a resolution? | Yes, members need at least 5% of votes or at least 100 members to put forward a special resolution | Not specified | Yes | Not specified | No |
| Typical fee structure | No particular regulations | Must adopt the "high-on-high" principle (payable only if the NAV/unit exceeds the NAV/unit on which the performance fee was last calculated and paid) | No particular regulations | No particular requirements | Fund manager and property manager fees should not exceed 1% of NAV of assets under their respective management |
| ^a To qualify as a MIT, the following criteria must be met: (1) Trustee must be an Australian resident, (2) the trust must be a Managed Investment Scheme (as defined in Chapter 5C of Corporations Act 2001), and (3) units in the trust must be "widely held." | | | | | |

Appendix B. Profiles of Selected REITs

| Table 1. HK-REITs | | | | | | | |
|---------------------------------|---|--|--|--|---|--|---|
| REIT (Bloomberg code) | Prosperity REIT (808:HK) | Champion REIT (2778:HK) | Sunlight REIT (435:HK) | Regal REIT (1881:HK) | GZI REIT (405:HK) | Fortune REIT (778:HK) | The Link REIT (823:HK) |
| <i>Manager's Fees</i> | | | | | | | |
| Manager | ARA Asset Management | Eagle Asset Management (CP) Ltd | Henderson Sunlight Asset Management Ltd | Regal Portfolio Management Ltd | GZI REIT Asset Management Ltd | ARA Asset Management | The Link Management Limited |
| Base fee | 0.4% per year on the value of properties | 12% of net property income (NPI) per year as long as NPI each half year is at least HK\$200 million | 0.4% per year on the value of properties | 0.3% (max 0.5%) per year of gross assets | 0.3% per year on the value of properties | 0.3% per year on the value of properties | NA |
| Performance fee | 3% of its NPI | NA | 3% per year NPI | 3% (max 5%) of NPI | 3% per year NPI | 3% per year of NPI | NA |
| Acquisition fee | Up to 1% of the acquisition price | Up to 1% of the acquisition price | Up to 1% of the acquisition price | 1% of the acquisition price | 1% of the acquisition price | Not exceeding 1% of the acquisition price | NA |
| Disposal fee | Up to 0.5% of the sale price | Up to 0.5% of the sale price | Up to 0.5% of the sale price | 0.5% of the sale price | 0.5% of the sale price | Not exceeding 0.5% of the sale price | NA |
| Trustee fee | Currently 0.03% per year (not exceeding 0.05% per year) on the value of the assets subject to min of HK\$50,000 a month | Not more than 0.03% per year of the value of the assets, subject to a min of HK\$200,000 a month (maximum 0.06% per year of the value of the assets) | 0.03% per year on the first \$5 billion on the total assets and 0.025% per year on the next \$5 billion and 0.02% per year on the balance subject to min of HK\$50,000 a month | 0.015%–0.025% per year based on the value of the assets subject to min of HK\$66,000 a month | 0.03% per year of the value of the assets (which may be increased to a maximum of 0.06% per year of the value of the assets subject to a min of HK\$50,000 a month) | 0.03% per year (subject to a minimum of HK\$50,000 a month) on the value of the assets | 0.008% per year subject to a min of HK\$150,000 a month |
| <i>Unitholders' Information</i> | | | | | | | |
| Manager | ARA Asset Management (Prosperity) Ltd | Eagle Asset Management (CP) Ltd | Henderson Sunlight Asset Management Ltd | Regal Portfolio Management Ltd | GZI REIT Asset Management Ltd | ARA Asset Management (Fortune) Ltd | The Link Management Limited |

(continued)

Table 1. HK-REITs (continued)

| REIT (Bloomberg code) | Prosperity REIT (808:HK) | Champion REIT (2778:HK) | Sunlight REIT (435:HK) | Regal REIT (1881:HK) | GZI REIT (405:HK) | Fortune REIT (778:HK) | The Link REIT (823:HK) |
|--|---|---|--|--|---|---|---|
| Sponsor | Cheung Kong Group | Great Eagle Holdings Ltd | Henderson Land Development Company Ltd (HLD) | Regal Hotels International Holdings Ltd (RHHIL) | GZI Group (principal subsidiary of Yue Xiu) | Cheung Kong Group | Divestment by the Hong Kong Housing Authority |
| Largest substantial unitholder of the REIT | Cheung Kong Group (20.95%) | Lo Ka Shui, chairman, founder, and managing director of Great Eagle Holdings Ltd (63.57%) | Lee Shau Kee, chairman and founder of HLD (33%) | Lo Yuk Sui, chairman, son of the founder, and CEO of RHHIL (74.5%) | Yue Xiu (36.55%) | Cheung Kong Group (35.6%) | Franklin Mutual Advisors (8.02%) |
| Relationship between the manager and the sponsor | Affiliate | Wholly owned | Indirectly wholly owned | Wholly owned | Wholly owned | Affiliate | None |
| <i>REIT Manager—Board of Directors</i> | | | | | | | |
| Board size | 7 | 8 | 6 | 9 | 6 | 9 | 11 |
| Number of INEDs (percent of board) | 3 (43%) | 3 (38%) | 3 (50%) | 3 (33%) | 3 (50%) | 3 (33%) | 9 (81%) |
| Separation of the role of CEO and chairman | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Is the chairman a non-executive director (NED), independent non-executive director (INED), or executive director (ED)? | NED | NED | NED | NED | ED | NED | INED |
| Is the chairman connected to the substantial unitholder and/or sponsor? | Yes, chairman is an executive director at Cheung Kong | Yes, chairman is also chairman and managing director of Great Eagle Holdings Ltd | Yes, Chairman is also an executive director and CFO at HLD | Yes, chairman is also chairman and CEO of RHHIL | Yes, chairman is the vice-chairman of Yue Xiu | Yes, chairman is an executive director at Cheung Kong | No |
| <i>Sources:</i> Data from annual reports for 2009 for Prosperity REIT, Champion REIT, Regal REIT, GZI REIT, and Fortune REIT; Annual reports for 2010 for Sunlight REIT and The Link REIT; and IPO circulars and company websites. | | | | | | | |

Table 2. S-REITs

| REIT (Bloomberg code) | Ascendas REIT (AREIT:SP) | CapitaCommercial Trust (CCT:SP) | CapitaMall Trust (CT:SP) | Mapletree Logistics Trust (MLT:SP) | Suntec REIT (SUN:SP) |
|----------------------------|--|---|--|--|--|
| <i>Manager's Fees</i> | | | | | |
| Base fee | 0.5% per year of the value of the deposited property | 0.1% per year of the value of the deposited property | 0.25% per year of the value of the deposited property | 0.5% per year of the value of the deposited property | 0.3% per year of the value of the deposited property |
| Performance fee | 0.1% per year of the deposited property, provided that the growth in distributions per unit (DPU) in a given financial year (calculated before accounting for the performance fee in that financial year) exceeds 2.5%; and an additional 0.1% per year of the deposited property, provided that the DPU growth exceeds 5% | 5.25% per year of CCT's net investment income before the manager's management fees and non-operating income, such as gains on disposal or revaluation of the properties | 2.85% of CMT's gross revenue for each financial year | 3.6% per year of the net property income in the relevant financial year (calculated before accounting for the performance fee in the financial year) | 4.5% of Suntec REIT's net property income |
| Acquisition fee | Not exceeding a maximum of 1% of the acquisition price for any real estate purchased. | 1% of the acquisition price of property acquired. | Not exceeding 1% of the purchase price paid by CMT | 1% of the acquisition price of real estate or real estate-related assets acquired | 1% of the acquisition price of any real estate purchased directly or indirectly. |
| Disposal or divestment fee | Not exceeding a maximum of 0.5% of the sale price. | 0.5% of the sale price of the property divested. | Not exceeding 0.5% of the sale price. | 0.5% of the sale price of real estate or real estate-related assets disposed. | 0.5% of the sale price of any real estate directly or indirectly sold or divested. |
| Trustee fee | Shall not exceed 0.25% per year of the value of all the gross assets of (deposited property) (subject to a minimum of \$10,000 per month) | Shall not exceed 0.10% per year of the value of deposited property (subject to a minimum sum of \$8,000 per month) payable out of the deposited property of the trust | Shall not exceed 0.10% per year of the deposited property (subject to a minimum sum of \$6,000 per month) payable out of the deposited property of the trust | Shall not exceed 0.1% per year of the value of all the assets of MapletreeLog deposited property (subject to a minimum of S\$10,000 per month) | Shall not exceed 0.25% per year of the value of the deposited property (subject to a minimum sum of \$9,000 per month) |

(continued)

| Table 2. S-REITs (continued) | | | | | | |
|--|---|---|--|--|-------------------------------------|--|
| REIT (Bloomberg code) | Ascendas REIT (AREIT:SP) | CapitaCommercial Trust (CCT:SP) | CapitaMall Trust (CT:SP) | Mapletree Logistics Trust (MLT:SP) | Suntec REIT (SUN:SP) | |
| <i>Unitholders' Information</i> | | | | | | |
| Manager | Ascendas Funds Management(S) Ltd (formerly named Ascendas-MGM Fund Management Ltd) ^a | CapitaCommercial Trust Management Ltd | CapitaMall Trust Management Ltd (formerly known as SingMall Property Trust Management Ltd) | Mapletree Logistics Trust Management Ltd | ARA Trust Management (Suntec) Ltd | |
| Sponsor ^b | (a) Ascendas Pte Ltd (b) Macquarie Goodman Industrial Management Pte Ltd | CapitaLand Ltd | CapitaLand Ltd | Mapletree Investments Pte Ltd | Suntec City Development Pte Ltd | |
| Largest substantial unit-holder of the REIT | Ascendas Pte Ltd (20.7%) | Temasek Holding (Private) Limited (32.0%) | Temasek Holding (Private) Limited (29.9%) Temasek owns a 40% stake in CapitaLand. | Temasek Holding (Private) Limited (44.4%) | Asean Investment Pte Ltd (5.4%) | |
| Relationship between the manager and the sponsor | Ascendas Funds Management(S) Ltd is a wholly-owned subsidiary of Ascendas Pte Ltd | Indirectly wholly-owned by the sponsor. CapitaLand is 40% owned by Temasek Holdings. | Indirectly wholly-owned by the sponsor. CapitaLand is 40% owned by Temasek Holdings. | Wholly-owned subsidiary of the sponsor. Mapletree Investment Pte Ltd is 100% owned by Temasek Holdings. | None | |
| <i>REIT Manager—Board of Directors</i> | | | | | | |
| Board size | 8 | 9 | 9 | 11 | 8 | |
| Number of INEDs (percent of board) | 6 (75%) | 3 (33%) | 4 (44%) | 4 (36%) | 3 (38%) | |
| Separation of the role of CEO and chairman | Yes | Yes | Yes | Yes | Yes | |

(continued)

Table 2. S-REITs (continued)

| REIT (Bloomberg code) | Ascendas REIT (AREIT:SP) | CapitaCommercial Trust (CCT:SP) | CapitaMall Trust (CT:SP) | Mapletree Logistics Trust (MLT:SP) | Suntec REIT (SUN:SP) |
|---|--------------------------------|---|--|---|----------------------------|
| Is the chairman a non-executive director (NED), independent non-executive director (INED), or executive director (ED) | INED | NED | INED | NED | NED |
| Is the chairman connected to the substantial unitholder and/or sponsor? | No | Yes. The chairman is a director on the board at CapitalLand | Yes. The chairman is an INED on the board at CapitalLand | Yes. The chairman is a director on the board of Mapletree Investments | No |

^aMacquarie Goodman sold its 60 percent stake in Ascendas-MGM Fund Management Ltd. back to Ascendas Group, and the manager was subsequently renamed Ascendas Funds Management(S) Ltd.

^bAll Sponsors listed in the table are as of the time of listing.

Sources: Annual Reports from 2009 for CapitaCommercial Trust, CapitaMall Trust, Mapletree Logistics Trust, and Suntec REIT; Annual Report from 2010 for Ascendas REIT; and IPO circulars and company websites.

Table 3. A-REITs

| REIT (Bloomberg code) | Bunnings Warehouse Property Trust (BWP:AU) | Charter Hall Retail REIT (CQR:AU) | ING Industrial Fund (IIF:AU) | Charter Hall Office REIT (CQO:AU) | Commonwealth Property Office Fund (CPA:AU) | CFS Retail Property Trust (CFX:AU) |
|--------------------------|--|--|--|--|---|---|
| <i>Manager's Fees</i> | | | | | | |
| Base fee | 0.55% of the gross asset value | 0.45% per year of the value of the total assets of the trust up to \$700 million plus 0.4% per year of the value of the total assets over \$700 million | Lower of 0.675% per year on the total assets of the fund and 9% of the fund's net income | 0.45% per year of the value of the total assets of the trust up to \$1 billion plus 0.4% per year of the value of the total assets over \$1 billion | 0.45% per year of the gross asset value | 0.45% per year of the gross asset value |
| Performance fee | 0.05% per year of the gross asset value of the trust up to \$200 million and 0.035% per year of the amount by which the gross asset value exceeds \$200 million. | Only payable if the performance of the trust is higher than the percentage increase in the Retail Property Trust Accumulation Index equal to 5% of the total increased unitholder value from outperformance plus 15% of the increased unitholder value above 2% nominal outperformance per year. Only payable if any prior period under-performance has been recovered by the trust since the last date a performance fee was earned. Subject to an annual cap in which total management fees paid in any one year must not exceed 80 bps of the value of the gross assets, except if outperformed over a 3-year period. | NA | Only payable if the performance of the trust is higher than the percentage increase in the Office Property Trust Accumulation Index equal to 5% of the total increased unitholder value from outperformance plus 15% of the increased unitholder value above 2% nominal outperformance per year. Only payable if any prior period under-performance has been recovered by the trust since the last date a performance fee was earned. Subject to an annual cap in which total management fees paid in any one year must not exceed 80 bps of the value of the gross assets, except if outperformed over a 3-year period. | Only paid if the fund's total return (distributions and capital growth) exceeds the S&P/ASX 200 Commercial Property Accumulation Index (excluding CPA). The fee is 5% of the gross asset value for the first 1% of outperformance and 15% for outperformance in excess of 1%. Any under-performance needs to be earned back before the RE can earn performance units. Capped at 0.15% per year of the fund's gross asset value up to \$3.5 billion and 0.1% per year for gross asset value above \$3.5 billion. | Only paid if the fund's total return (distributions and capital growth) exceeds the UBS Retail 200 Property Accumulation Index (excluding CFX). The fee is 5% of the gross asset value for the first 1% of outperformance and 15% for outperformance in excess of 1%. Any under-performance needs to be earned back before the RE can earn performance units. Capped at 0.15% per year of the fund's gross asset value up to \$3.5 billion and 0.1% per year for gross asset value above \$3.5 billion. |

(continued)

| Table 3. A-REITs (continued) | | | | | | |
|--|---|--|---|---|---|---|
| REIT (Bloomberg code) | Bunnings Warehouse Property Trust (BWP:AU) | Charter Hall Retail REIT (CQR:AU) | ING Industrial Fund (IIF:AU) | Charter Hall Office REIT (CQO:AU) | Commonwealth Property Office Fund (CPA:AU) | CFS Retail Property Trust (CFX:AU) |
| <i>Unitholders' Information</i> | | | | | | |
| Responsible entity | Bunnings Property Management Limited | Charter Hall Retail Management Limited (used to be Macquarie CountryWide Management Limited ^a) | ING Management Limited | Charter Hall Office Management Limited (used to be Macquarie Office Management Limited ^b) | Commonwealth Managed Investments Limited | Commonwealth Managed Investments Limited (used to be Gandel Management Limited ^c) |
| Sponsor ^d | Wesfarmers | Macquarie Bank | ING Group | Macquarie Bank | Commonwealth Bank of Australia (CBA) | Gandel Group |
| Largest substantial unitholder of the REIT | Wesfarmers (22%) | Charter Hall Group (17.46%) | ING Group (11.67%) | Charter Hall Group (15.69%) | CBA (12.12%) | Gandel Group (17.05%) |
| Relationship between the manager and the sponsor | Wholly owned | Wholly owned | Wholly owned | Wholly owned | Wholly owned | Wholly owned |
| <i>REIT Manager—Board of Directors</i> | | | | | | |
| Board size | 5 | 6 | 5 | 6 | 5 | 5 |
| Number of INEDs (percent of board) | 4 (80%) | 3 (50%) | 4 (80%) | 3 (50%) | 3 (60%) | 3 (60%) |
| Separation of the role of CEO and Chairman | Yes | Yes | Yes | Yes | Yes | Yes |
| Is the Chairman a non-executive director (NED), independent non-executive director (INED), or executive director (ED)? | INED | ED | INED | ED | INED | INED |

(continued)

Table 3. A-REITs (continued)

| REIT (Bloomberg code) | Bunnings Warehouse Property Trust (BWP:AU) | Charter Hall Retail REIT (CQR:AU) | ING Industrial Fund (IIF:AU) | Charter Hall Office REIT (CQO:AU) | Commonwealth Property Office Fund (CPA:AU) | CFS Retail Property Trust (CFX:AU) |
|---|---|--|------------------------------------|--|---|--|
| Is the chairman connected to the substantial unitholder and/or sponsor? | No | Yes. The chairman is the founder and joint managing director of Charter Hall Group | No | Yes. The chairman is the joint managing director of Charter Hall Group | No | No |

^aMacquarie CountryWide Management Limited sold the management rights of Macquarie CountryWide Trust to Charter Hall Group in February 2010; the REIT was renamed Charter Hall Retail Trust and is now managed by Charter Hall Retail Management Limited.

^bMacquarie Office Management Limited sold the management rights of Macquarie Office Trust to Charter Hall Group in February 2010; the REIT was renamed Charter Hall Office Trust and is now managed by Charter Hall Office Management Limited.

^cResponsible entity changed from Gandel Management Limited to Commonwealth Managed Investments Limited in October 2002 after CFX, then called Gandel Retail Trust, acquired Colonial First State Retail Property Trust. Gandel Group sold its joint interest in the manager in May 2006 to Colonial First State, and the trust was renamed CFS Retail Property Trust.

^dAll sponsors listed in the table are as of the time of listing.

Sources: Information from annual reports for 2010, IPO circulars, and company websites.

| Table 4. J-REITs | | | | | | |
|---|--|---|---|--|--|---|
| REIT (Bloomberg code) | Nippon Building Fund Inc (8941:JP) | Japan Real Estate Investment Corporation (8952:JP) | Japan Retail Fund Investment (8953:JP) | Orix Jreit Inc (8954:JP) | Japan Prime Realty Investment (8955:JP) | Premier Investment Co (8956:JP) |
| <i>Manager's Fees</i> | | | | | | |
| Base fee | 2.50% per year based on rental income | Maximum of 8% based on cash flow per business period | 0.60% per year based on asset volume | 0.175% based on asset volume per business period | Variable, but maximum of 2% per year based on rental income and fixed fee of ¥12.5 per month | 3% per year based on rental income |
| Performance fee | 3% per year based on profit level | 30% based on historical positive cash flow differentials | NA | 3% per year based on profit level | 3% per business period based on profit level | 3% per year based on profit level |
| Acquisition Fee | Variable depending on acquisition price; maximum of 0.5% | Variable depending on acquisition price; maximum of 0.5% | 0.8% of acquisition price | Variable depending on acquisition price; maximum of 0.5% | 0.25% of acquisition price | Variable depending on acquisition price; maximum of 0.5% |
| Disposal fee | NA | maximum of 0.5% | NA | maximum of 0.5% | NA | NA |
| <i>Unitholders' Information</i> | | | | | | |
| Manager | Nippon Building Fund Management Ltd. | Japan Real Estate Asset Management Co., Ltd. | Mitsubishi Corp.—UBS Realty Inc. | ORIX Asset Management Corporation | Tokyo Realty Investment Management, Inc. | Premier REIT Advisors Co., Ltd. |
| Sponsor | Mitsui Fudosan (8801) | Sponsors include Mitsubishi Estate (8802), Dai-ichi Mutual Life (8750), and Mitsui & Co. (8031) | Mitsubishi (8058) and UBS | Orix (8591) | Tokyo Tatemono (8804), Meiji Yasuda Life Insurance, Taisei (1801), Yasuda Real Estate, and Sompo Japan Insurance | Sponsors include Ken Corporation, Sohgo Real Estate, and Chuo Mitsui Trust Bank, NTT Urban Development (main sponsor) |
| <i>Source: Information based on public filings.</i> | | | | | | |

Appendix C. Sources and Resources

Official REIT Codes and Regulations

Australia

- Australian Government, Corporations Act 2001: <http://scaleplus.law.gov.au/ComLaw/Legislation/Act1.nsf/0/618AABD8E453AE27CA256F72000C6CC1?OpenDocument>

Hong Kong

- Securities and Futures Commission, Code on Real Estate Investment Trusts (last updated June 2010): <http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H586>

India

- Securities and Exchange Board of India, Draft for Comment, Real Estate Investment Trusts Regulations, 2008; <http://www.sebi.gov.in/commreport/RealEstateReg.pdf>

Japan

- Act on Investment Trusts and Investment Corporations (ITL): www.japaneselawtranslation.go.jp/law/detail/?id=1903&vm=04&re=01
- Financial Services Agency, Financial Instruments and Exchange Act (FIEL): www.fsa.go.jp/en/news/2008/20080627-4/02.pdf

The Philippines

- Philippines House of Representatives, The Republic Act No. 9856 (REIT Law): www.congress.gov.ph/download/ra_14/RA09856.pdf
- Securities and Exchange Commission, Implementing Rules and Regulations of the Real Estate Investment Trust (REIT) Act of 2009: www.sec.gov.ph/irr-reit-act/REIT%20IRR%20as%20approved%20on%20May%2013%202010.pdf

Singapore

- Monetary Authority of Singapore, Code on Collective Investment Schemes (Last updated 11 November 2009): www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/CIS_Code_11_Nov_2009.pdf

Key Regulatory Websites

Australia

- Australian Securities and Investments Commission: www.asic.gov.au

Hong Kong

- Securities and Futures Commission: www.sfc.hk/sfc/html/EN/

India

- Securities and Exchange Board of India: www.sebi.gov.in/

Japan

- Financial Services Agency: www.fsa.go.jp/en/index.html

The Philippines

- Securities and Exchange Commission: www.sec.gov.ph/

Singapore

- Monetary Authority of Singapore: www.mas.gov.sg/index.html

CFA Institute

Author

Angela Pica, CFA

Policy Analyst

Asia-Pacific Office

CFA Institute

Contributors

Kurt Schacht, JD, CFA

Managing Director

Standards and Financial

Market Integrity

CFA Institute

Katrina Tai

Director

Standards and Financial

Market Integrity

Asia-Pacific Office

CFA Institute

Lee Kha Loon, CFA

Head

Standards and Financial

Market Integrity

Asia-Pacific Office

CFA Institute

Alexander Flatscher, CFA

Chair

Advocacy Committee

CFA Society of Japan

THE AMERICAS

560 Ray C. Hunt Drive
P.O. Box 3668
Charlottesville, VA, USA 22903-0668

(800) 247-8132 **PHONE (USA and Canada)**
+1 (434) 951-5499 **PHONE**
+1 (434) 951-5262 **FAX**

21st Floor
477 Madison Avenue
New York, NY, USA 10022-5802

ASIA-PACIFIC

Suite 4905-08
One Exchange Square
8 Connaught Place, Central
Hong Kong SAR

+852 2868-2700 **PHONE**
+852 8228-8820 **INFO HOTLINE**
+852 2868-9912 **FAX**

EUROPE

10th Floor
One Canada Square
Canary Wharf
London, UK E14 5AB

+44 (0) 20-7531-0751 **PHONE**
+44 (0) 20-7531-0767 **FAX**

Square de Meeûs 38/40
1000 Brussels, Belgium

info@cfainstitute.org **E-MAIL**

www.cfainstitute.org

