

Is There A Business Case For REITs In Singapore?

by

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Bachelor of Science in Building, 1996
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Submitted to the Department of Architecture
in partial fulfillment of the Degree of

Master of Science in Real Estate Development

at the

Massachusetts Institute of Technology

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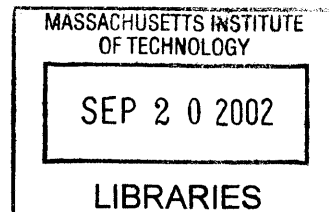
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ROTCH

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ABSTRACT

In an attempt to determine whether there is a business case for the establishment of a Real Estate Investment Trust in Singapore(SREIT), we analyzed the market fundamentals and the regulatory framework governing the SREIT. A case study on the failure of the first SREIT offering is also presented with the aim of examining the prospects of SREITs going forward.

We found that there is a viable business case for REITs in Singapore. On the supply side, there is a strong impetus for real estate owners to divest their properties after the Asian Economic Crisis due to the capital intensive and low return nature of these assets. On the demand side, there is clear investor demand for yield based investment instruments like SREIT given the significant amount of investible funds from the Central Provident Fund and retail deposits. Except for the lack of full tax transparency, the SREIT regulatory framework is largely in line with international best practices. On the failure of the first SREIT offering, we found that the key factors contributing to the failure were specific to the trust itself and had little to do with the broader market conditions like supply, demand and regulation.

Thesis Advisor: John Riordan
Title: Chairman, Center for Real Estate

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My sincere thanks also goes out to every industry professional who took the time to meet with me and provided invaluable information on REITs in Singapore.

This thesis is dedicated to two very important people in my life.

To my husband, Chee-Kiong, for his understanding and support during this extraordinary year, and for posing incisive questions and helping to pull this thesis together.

and

In memory of my beloved mother, for the courage and strength that she demonstrated in her battle against cancer. Her great compassion and strong fighting spirit shall live forever in my heart.

TABLE OF CONTENTS	Page
Abstract	2
List of Figures	7
List of Tables	8
1. Introduction	
1.1 Background	9
1.2 Scope of Research	9
1.3 Methodology	10
2. Supply of Real Estate Assets into SREITs	
2.1. Pre-Asian Economic Crisis	11
2.2. The Asian Economic Crisis in 1997	11
2.3. The Current Situation in Singapore	12
2.4. Modes of Divesting	13
2.5. Supply of Investment Grade Properties	15
3. Demand for SREITs	
3.1. Introduction	18
3.2. Central Provident Fund (CPF)	19
3.2.1. Liberalization of CPF Investment Rules	19
3.3. Retail Investors	20
3.4. Insurance Companies	21
3.5. General Equity Funds & Specialist Real Estate Securities Funds	23
3.6. SREITs vs. Other Investment Products	
3.6.1 REITs vs. Other Equity Sectors	23
3.6.2 REITs vs. Bonds	25
3.6.3 SREITs vs. Unit Trusts	25
3.6.4 SREITs vs. Direct Real Estate Investment	26
4. Global Perspective – REITs in the U.S. and Australia	
4.1. REITs in the U.S.	27
4.1.1 History of U.S. Equity REITs	28
4.1.2 Tax and Management Structure	29
4.1.3 Ownership Structure	30
4.2. REITs in Australia	32
4.2.1 Historical Background	32
4.2.2 Tax and Management Structure	32
4.3. U.S. REITs vs. Australian Listed Property Trusts (LPTs)	33
4.3.1 Tax Transparency – A Common Key Success Factor	33
4.3.2 Key Differences Between U.S. REITs and LPTs	34

5. Regulatory Framework For REITs in Singapore	
5.1. The Property Trust Guidelines	37
5.2. Key Differences Between U.S. REITs and SREITs Regulations	39
5.3. Issues Concerning SREITs Guidelines	40
5.4. Future Developments	42
6. Singapore Property Trust (SPT)	
6.1. Introduction to Singmall Property Trust	43
6.2. Strengths of SPT	44
6.3. Weaknesses of SPT	47
6.4. Factors Contributing to Failure of SPT	48
6.5. Future Interests in SREITs	50
6.6. Key Initiatives by SREITs Sponsors	51
6.7. Outlook for SREITs	51
7. Conclusion	52
Endnotes	54
Bibliography	56
Appendix A	59
List of Interviewees	72

<u>List of Figures</u>		<u>Page</u>
Figure 1	Current Ownership Structure of Investment Grade Properties in Singapore	16
Figure 2	Percentage Distribution of Insurance Funds	22
Figure 3	US Equity REITs' Performance vs. Other Indices	24
Figure 4	Absolute Performance of CPF-Approved Investment Products	25
Figure 5	Traditional REIT Structure	30
Figure 6	The UPREIT Structure	31
Figure 7	Government Bond Yield Curve	44
Figure 8	Rental Income by Tenant Type	46
Figure 9	SPT's Lease Expiry Profile	47

<u>List of Tables</u>		<u>Page</u>
Table 1	SREITs vs. Asset Securitization	14
Table 2	Detailed Breakdown on the Current Ownership Structure of Investment Grade Properties in Singapore	16
Table 3	Property Companies and Corporates Considering SREITs	17
Table 4	SREITs and LPT Unit Holding Distribution	18
Table 5	Interest Income on Singapore Deposits	21
Table 6	Investment Limits of Singapore Life Insurance Funds	22
Table 7	US Equity REITs' Correlation with Other Indices	24
Table 8	International REIT Market Comparison	34
Table 9	Dividend Distribution Comparison Between US Equity REITs and Australian LPTs	36
Table 10	Current Legal & Tax Structure in Singapore	38
Table 11	Differences between Singapore and US REIT Regulations	39
Table 12	SPT's Property Portfolio	43
Table 13	Comparative Dividend Yields	45

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

A Real Estate Investment Trust(REIT) is a vehicle dedicated to owning income-producing property, such as office, retail and industrial property. Rather than owning the property directly, investors buy and sell units in a REIT, which acts as a conduit. The income generated by a REIT is taxed in the hands of unitholders, rather than at an entity level.

The idea of introducing Real Estate Investment Trusts in Singapore was first mooted in 1986 by the Property Market Consultative Committee, set up to help revitalize the weak property market then. After 13 years and much lobbying by the Real Estate Developers' Association of Singapore, the most important institutional hurdle was cleared when the guidelines for the formation of REITs were finally released by the Monetary Authority of Singapore (MAS)¹ on May 14 1999. Following the removal of the regulatory hurdle, the first of the Singapore Real Estate Investment Trusts (SREITs) – the SingMall Property Trust (SPT) – was set to debut in November 2001. However, it was pulled out just a few hours before the retail tranche was due to close. What went wrong?

1.2 SCOPE OF RESEARCH

This thesis aims to undertake a detailed study to determine if there is a business case for the establishment of SREITs. Chapter Two analyses the supply side factors. It starts by looking at the structural changes that the Singapore real estate industry is undergoing and that serve as motivations for real estate owners to divest their properties. It then establishes that the REIT is the most attractive mode of divesting given the present market conditions by comparing the REIT with other modes of divesting, namely outright sale and asset securitization. This is

followed by an attempt to estimate the potential size of investment grade properties which could be divested into SREITs, and the potential suppliers of such properties.

Chapter Three examines the investor demand for SREITs. The potential investor classes are identified and the potential size of funds from the key investor classes is estimated. The relative attractiveness of the SREIT vis-à-vis the other competing investment products (e.g. equities and bonds) is also analyzed.

Chapter Four studies the REIT market in the U.S. and Australia, focusing on their historical evolution, and the tax, ownership and management structure of the REITs in these markets. A comparative analysis of these two markets is performed to identify their common key success factors and key differences. This is to provide lessons for the development of SREITs.

Chapter Five reviews the existing regulatory framework governing the SREIT to determine whether it is in line with international market practices and to identify areas of improvement where appropriate.

Chapter Six presents a case study on the key factors contributing to the failure of the first SREIT offering. The aim here is to examine the prospects of SREITs going forward.

The overall conclusion on whether there is a business case for establishing a SREIT is presented in Chapter Seven.

1.3 METHODOLOGY

The author relied on interviews with key industry professionals (who are involved in REITs in one way or another) and desk research for the information presented in this thesis. The industry professionals interviewed included investment bankers, property consultants, owner/manager of REITs and financial service regulators. All the interviews were conducted in person (please refer to the List of Interviewees). The information sources for the desk research included web sites, business magazines, newspaper articles and investment banking research reports.

CHAPTER 2

SUPPLY OF REAL ESTATE ASSETS TO SREITs

2.1 PRE-ASIAN ECONOMIC CRISIS

The Singapore real estate industry, in particular the commercial property market, has often been described as immature, with transactions at “trophy value” (at a price that can hardly be justified by the underlying cash flows) which often results in negative yield gaps. Surprisingly, asset buyers, formed mostly by private individuals or companies funded by easy credit, accept such valuations because they, in turn, expect massive capital gains which would make up for the negative yield. However, this perception changed when the economic crisis hit the Asian countries in the later part of 1997.

2.2 THE ASIAN ECONOMIC CRISIS IN 1997

The basic story of the Asian Economic Crisis can be summarized as follows: Foreign investment, lured by high returns, stable government and currencies pegged tightly to the dollar, began pouring into the region in the 1990s. The foreign money financed factories, power plants, skyscrapers and airports for a booming export economy. Success beget success and this led to overbuilding, overlending and overconsumption.

The first signs of serious trouble appeared when the supercharged Thai economy began to slow in Spring, 1997, triggering a speculative run against the Thai baht by currency traders hoping to profit from a devaluation. In a vain attempt to defend its currency, the Thai central bank depleted its reserves of foreign currency. When the devaluation finally came in July 1997, the foreign investors fled, thus breaking the speculative cycle.²

The effects of the Thai crisis rippled rapidly across Asia, bursting bubbles in the other Asian countries too. Real estate prices plummeted, stock prices fell and local currencies went into free fall. Banks and corporations, which had borrowed heavily in dollars, yen and marks, found that they could not repay.³ In one country after another, foreign investors came to realize that what was true in Thailand was also true in many of the other Asian Tigers.⁴ Weak banks in one country called in loans elsewhere, causing the contagion to spread excessively.

2.3 THE CURRENT SITUATION IN SINGAPORE

Since the Asian Economic Crisis, there has been an evident change in the profile of buyers for real estate in Singapore and most of Asia. Where individuals, private vehicles and non-real estate companies used to be buyers at “trophy value” prior to the Asian Economic Crisis, this is less apparent today. For example, a number of non-real estate companies are now reverting to their core businesses and divesting non-core assets like real estate. Instead, potential buyers of investment properties today are predominantly institutions (i.e. real estate funds). Hence, tolerance for a negative yield gap is low as cash flows of the underlying assets are required to fund dividends to investors.

Apart from the change in the profile of buyers, there has been a marked change in attitude of real estate owners since the Asian Economic Crisis as they begin to understand investors’ need for higher returns. Real estate assets which were once regarded as core assets are now seen as “liabilities” because they are low return and capital intensive in nature.

The other key impetus for the divesting of real estate assets comes from the Monetary Authority of Singapore(MAS) directive to the banks to divest their non-core assets such as real estates by 18 July 2004. As a result, the banks have to reduce their permitted property holdings from the present limit of 40% to 20% of a bank’s capital funds.⁵ The only exceptions are where:

- a. head office buildings can be classified as operating assets; and
- b. banks can retain a 10% associate investment in a listed real estate company.

Given these reasons, we can see that the Singapore real estate industry is undergoing a significant structural change and that there is now a real need for some real estate owners in Singapore to divest their properties.

2.4 MODES OF DIVESTING

The various modes of divesting available to real estate owners include outright sale, asset securitization and setting up a REIT.

While there are real estate funds looking to buy occasionally, it is generally not easy to find buyers for the outright sale of real estate assets in Singapore, especially those costing over S\$500m. Hence, outright sale is a less attractive option as compared to asset securitization and REITs.

The other option is asset securitization,⁶ which allows real estate owners to raise capital through the fixed income market. This mode of divesting became popular in 1998 as a means of raising capital to de-leverage balance sheets that had ballooned through the residential landbank re-stocking that took place in Singapore during the mid-1990s.

Another option is REIT which we believe is the most effective vehicle for real estate owners in Singapore to divest their properties. This is because it offers the following two key advantages over asset securitization:

A. Return On Equity (ROE) benefits

Selling properties into a SREIT would constitute a sale and therefore effect off-balance sheet treatment (only if the vendor subscribes to less than 25% of the SREIT’s equity and is not deemed to have any beneficial control over the assets). This could potentially be ROE-enhancing if the capital is subsequently re-deployed into higher yielding pursuits or returned to unit holders. In the case of asset securitization, the difficulty in achieving off-balance sheet treatment means that companies would be further leveraging their balance sheets and therefore be unable to improve balance sheet ratios.⁷

B. Greater liquidity

As listed entities, REITs are likely to have greater liquidity and would appeal to a broader range of investors, including general equity managers, real estate security funds, insurance funds and retail investors. In contrast, the junior bond or equity components of asset securitization are generally unlisted and appeal to a limited universe of investors that have discretionary funds available to invest in unlisted real estate structures.

Table 1: REITs vs. Asset Securitization

	REITs	Asset Securitization
Potential development of real estate management business	Yes	No
Improvement in ROE	Positive	Positive only if it constitutes a real sale
Accounting treatment	Off balance sheet	Unlikely to achieve off balance sheet treatment
Investor interest in equity component	High as it attracts diversified investor base	Investors to participate in unlisted structures

2.5 SUPPLY OF INVESTMENT GRADE PROPERTIES

Having established that there is a real need for real estate owners in Singapore to divest their properties and that SREITs could provide them an attractive solution, we will next estimate the value of investment grade properties that could be divested into SREITs and identify the likely suppliers of these properties.

There is approximately S\$43bn of investment grade retail and office real estate in Singapore.⁸ The breakdown between retail and office is S\$13bn and S\$30bn respectively.

Banks control approximately 26% of the total retail and office investment grade properties, with United Overseas Banking Group(UOB) at the top of the list (see Table 2). The government-linked companies including CapitaLand and Keppel Land control approximately 25% of the total retail and office investment grade properties. Separately, the Hong Leong Group (including the listed entity City Developments) controls 11% of the total retail and office investment grade properties. The balance is owned by the other listed property companies including Allgreen, First Capital Corporation and Wing Tai Holdings, Suntec City and privately held companies such as Kwee Holdings and Ngee Ann Holdings. The overall breakdown is summarized in Figure 1 and Table 2.

It is worth noting that CapitaLand and Keppel Land have announced their intention to transfer sizeable portions of their investment grade properties into SREITs over the next three years. The list of companies that are considering SREITs to divest their investment grade properties is presented in Table 3. If 60% of total investment grade properties currently held by banks and government-linked companies was transferred to SREITs over the next three years, the SREIT sector could grow approximately to S\$13.2bn by mid-2004. Assuming an 80% free float, the SREIT sector could soon overtake the free float market capitalization of the existing listed property sector (current total S\$9.2bn).

Figure 1: Current Ownership Structure of Investment Grade Properties in Singapore

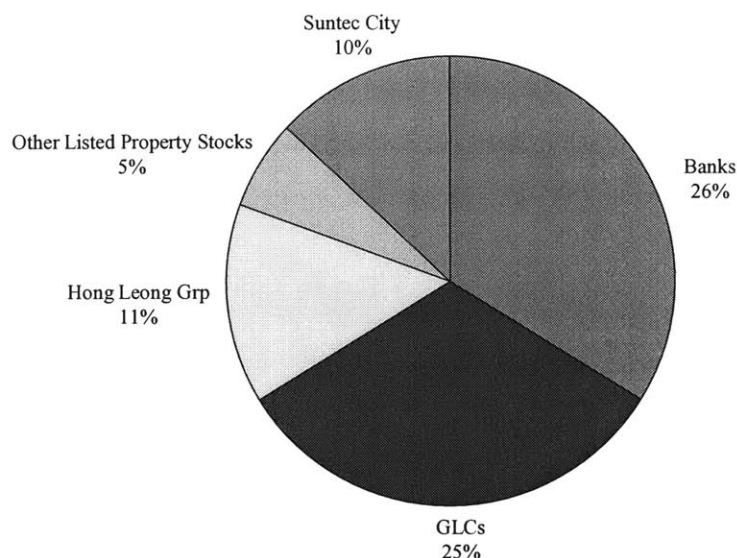


Table 2: Detailed Breakdown on the Current Ownership Structure of Investment Grade Properties in Singapore

	Retail (S\$m)	% of Total Retail	Office (S\$m)	% of Total Office	Total Retail & Office
UOB Group (inc Singland & UIC)	882	6.8%	5,204	17.3%	-
OCBC Group (inc Centerpoint)	1,593	12.3%	1,643	5.5%	-
DBS Group	-	-	1,278	4.3%	-
OUB Group	-	-	630	2.1%	-
Sub-total banks	2,475	-	8,755	-	26%
Keppel Group	306	2.4%	3,326	11.1%	-
CapitaLand Group	2,926	22.6%	4,270	14.2%	-
Sub-total GLCs	3,232	-	7,596	-	25%
Hong Leong Grp	1,584	12.2%	3,144	10.5%	11%
Other Listed Property Companies	1,006	7.8%	1,230	4.1%	5%
Suntec City	1,332	10.3%	2,760	9.2%	10%
Privately held (insurance cos)	3,298	25.5%	6,526	21.7%	23%
Total (S\$)	12,927	-	30,010	-	42,937

Source: UBS Warburg

Table 3: Property Companies and Corporates Considering SREITs

	Asset Type	Potential Asset Size	Properties Likely to be Injected
CapitaLand	Retail Mall REIT	S\$770m	Tampines Mall, Junction 8, Funan Center.
F & N	Retail Mall REIT	< S\$1.4bn	Centerpoint, Northpoint, Causeway Point, Anchorpoint and Compass Point.
Keppel Land	Office REIT	S\$1.1bn	Ocean Towers, Capital Square and Prudential Tower.
SPH	Possibility of Listing 'Times Properties' as REIT later	S\$1.1bn	Paragon, Promenade, Times House and Times Industrial Building.
DBS Bank	Office REIT	S\$1.0bn	DBS Tower 1, DBS Tower 2 and PWC Building.
OCBC Group	Retail Mall REIT	S\$350m	Owns Specialist Center and White Sands shopping malls.
Suntec City	Office REIT	S\$2.5bn	5 office blocks in the Suntec City area with net lettable area of about 2.3m square feet.

Source: Saloman Smith Barney Inc

CHAPTER 3

DEMAND FOR SREITs

3.1 INTRODUCTION

SREITs will create a new product in the Singapore financial market. Therefore, it is important that SREITs appeal to a broad range of investors to ensure wide distribution and liquidity. In this chapter, we attempt to identify the various investor classes for SREITs and examine the potential competing investment products to SREITs.

Table 4 presents a profile of the various investor classes in the Australian Listed Property Trust (LPT) market. According to the estimates¹⁰ by UBS Warburg, the demand pool for SREITs will not be substantially different from that of the LPTs.

Table 4: SREITs and LPT Unit Holding Distribution

	Singapore % of Total	A\$bn	Australia % of Total
Insurance Funds	20	5.3	15
Local Institutional Funds	20	10.6	30
Retail	20	10.5	30
Property Security Funds	10	5.3	15
Overseas Investors	10	1.8	5
Vendor/ Sponsor	20	1.8	5
	100	35.0	100

Source: UBS Warburg

Let us take a look at the various investor classes likely to be investors in SREITs.

3.2 CENTRAL PROVIDENT FUND

Singapore finances its social security system through a publicly managed mandatory program of private savings known as Central Provident Fund (CPF). Unlike social security systems in other countries, the CPF is fully funded. Members are employed Singaporeans and permanent residents who accumulate assets in individual accounts. Both the employer and the individual make monthly contributions to the CPF. A CPF member maintains three accounts: Ordinary, Medisave and Special Accounts. At age 55, the member also has a Retirement Account under the Minimum Sum Scheme. Savings in the Ordinary Account can be used for housing, investments, CPF insurance, tertiary education and topping-up of parents' retirement accounts. The Medisave Account can be used for hospitalization expenses, approved outpatient treatments such as chemotherapy and radiotherapy, and approved medical insurance. The Special Account is a cash account for old age use and contingency purposes.

3.2.1 Liberalization of CPF Investment Rules

In 1 January 2001, the government liberalized the rules governing the Central Provident Fund (CPF) investment¹¹. The key changes included:

- A. CPF members are allowed to use their full Special Account savings to invest in approved retirement-related financial instruments under the CPF Investment Scheme-Special Account (CPFIS-SA).
- B. CPF members no longer need to set aside the Minimum Sum before they invest their savings. Investible savings will be redefined as the Ordinary Account balance plus amounts withdrawn for investment and education.

The move to liberalize the use of CPF funds could spearhead demand for yield-based products like SREITs and bonds, and therefore the development of these two markets. In effect, the government is “privatizing” the management of CPF funds. It has been subsidizing the return on Special Account funds as the guaranteed 4% is above interbank rates. Already, several banks and fund management firms have started gearing to tap such funds. The Development Bank of Singapore (DBS), for instance, has been aggressively marketing their low-risk fund “Up”, which guarantees a 2% minimum return on Special Account funds held with the bank.¹² As more banks and asset management firms set up similar capital guarantee funds, they need low beta, steady yielding instruments to help them structure their portfolios. SREITs are likely to fit the bill.

The pool of idle funds that can potentially be unlocked from CPF is very large. Based on data published by CPF as at 31 March 2002, the CPF fund balance is S\$150bn, of which S\$52bn is still available for investment. Currently, CPF holds S\$8.3bn in stocks and S\$33bn has been drawn down for purchases of residential properties. If the CPF were to eventually allocate 6-7% of funds to SREITs (the same ratio as in Australia and treated as a separate asset class than equities), then there could be as much as S\$9-11bn in domestic provident fund flows for SREITs over the long term.¹³

3.3 RETAIL INVESTORS

As indicated in Table 4, retail investors account for approximately 30% of the total Listed Property Trust sector demand in Australia, representing the largest single investor class. In Australia, retail investors are attracted to LPTs as they provide diversification, yield a premium over cash deposit rates, are liquid and are a relatively more secure investment with lower volatility than general equities.

As of May 2000, the total amount of corporate and individual deposits was S\$138bn.¹⁴ This demand pool could account for a significant component of total SREIT demand for the following reasons:

- A. With tax transparency, SREIT investors should receive dividends free of tax deducted at source. This would make SREIT dividends comparable with savings and fixed deposits, which are also paid without tax deduction at source. In addition, investors also benefit from the timing advantage of paying tax when they are assessed.
- B. Yields are attractive relative to savings and fixed deposits which pay interest ranging between 0.35% and 0.81% compared with a potential SREIT yield of 5-6% (Table 5).¹⁵

Table 5: Interest Income on Singapore Deposits

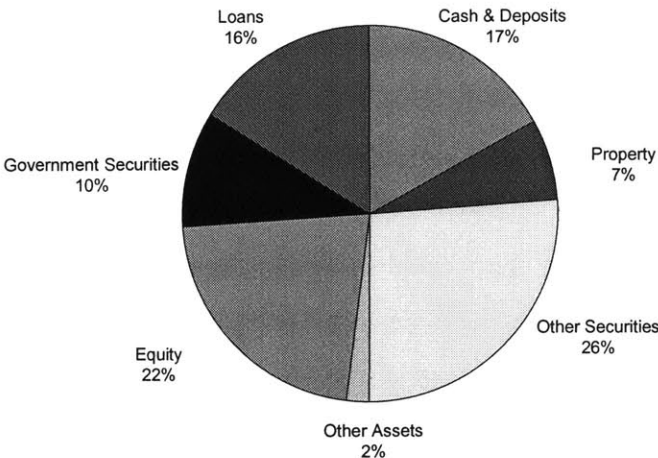
Type of Deposits	Interest Rates		
	3 months	6 months	12 months
Fixed Deposits-Cash (S\$)	0.5%	0.5625%	0.8125%
Savings Deposits (S\$)	-	-	0.35%

Source: Development Bank of Singapore (as at Jun 2002)

3.4 INSURANCE COMPANIES

SREITs are likely to be classified as listed unit trusts. Hence, insurance funds should be able to invest up to 45% of their funds into SREITs instead of the current 25% limit imposed on direct real estate or listed real estate companies. However, most insurance funds are underweight in equities with only 22% invested against the 45% insurance guideline limit. In addition, over time insurance companies may follow their Australian counterparts and transfer their S\$1.8bn in direct real estate holdings to SREITs.

Figure 2: Percentage Distribution of Insurance Funds



Source: Insurance Industry Performance

Table 6: Investment Limits of Singapore Life Insurance Funds

	Insurance Funds
Unit Trust, equity shares, pref. Shares, subscription rights and warrants	45%
Direct and listed real estate	25%
Foreign currencies and outstanding assets	30%
Unsecured loans	10%

Source: Monetary Authority of Singapore (MAS)

In Australia, an increasing number of insurance companies prefer to hold LPTs rather than direct properties. The main reasons are:

- a. higher liquidity allowing insurance companies to meet redemptions in an efficient manner; and
- b. the ability to mark-to-market insurance companies’ real estate exposure rather than relying on yearly real estate valuations.

3.5 GENERAL EQUITY FUNDS AND SPECIALIST REAL ESTATE SECURITIES FUNDS

General equity funds represent the smallest investor class, representing only 10-15% of the total LPT sector (Table 4). However, LPTs and U.S. Equity REITs have become increasingly popular given the volatility and high valuations of technology stocks compared with the relatively defensive qualities of REITs. Although the composition of general equity funds tends to fluctuate with investment trends, it provides an important source of liquidity for the U.S. Equity REIT and LPT sectors.

In Australia, specialist real estate security funds account for 15% of the total LPT sector demand. These funds trade on their views of the supply and demand fundamentals that affect the office, retail and industrial sectors.¹⁶

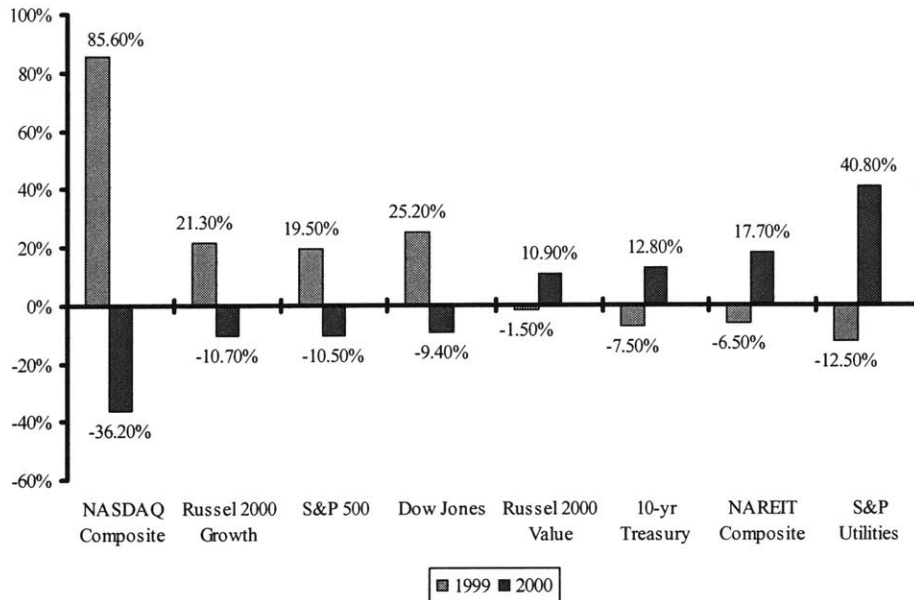
3.6 SREITs VS. OTHER INVESTMENT PRODUCTS

3.6.1 REITs vs. Other Equity Sectors

As REITs are well established in Australia and the U.S., we have attempted to compare the price behavior of REITs to other equity classes in their respective countries. This should provide an indication of how SREITs are likely to perform.

Recently in Australia and the U.S., investor unease with technology stock valuations and the uncertain economic outlook have led to a significant increase in stock market volatility. In an attempt to lower portfolio betas, investor attention has shifted to companies that have more predictable cash flows and higher dividends and that trade on lower earnings multiples. Figure 3 exhibits the change in sentiment that led to a 17.7% outperformance in the National Association REIT (NAREIT) Composite index in 2000 (compared with the 6.5% underperformance in 1999). The returns exhibit the negative correlation with NASDAQ and S&P 500 that underperformed by 36.2% and 10.5%, respectively, in 2000.

Figure 3: U.S. Equity REITs' Performance vs. Other Indices



Source: NAREIT

Table 7 shows that recently U.S. Equity REITs have a 0.28 correlation with the S&P 500, which is low, and have the lowest correlation with NASDAQ 100. This characteristic makes U.S. Equity REITs useful products when managing portfolio betas. While the correlation of U.S. Equity REITs with other indices could shift dramatically, the underlying reliable returns from the REITs should help them sustain their attractiveness to certain investors interested in stability.

Table 7: U.S. Equity REITs' Correlation with Other Indices

	1995-2000
Russell 2000	0.36
S&P 500	0.28
NASDAQ Composite	0.09
S&P Utilities	0.37
NASDAQ 100	0.01

Source: NAREIT

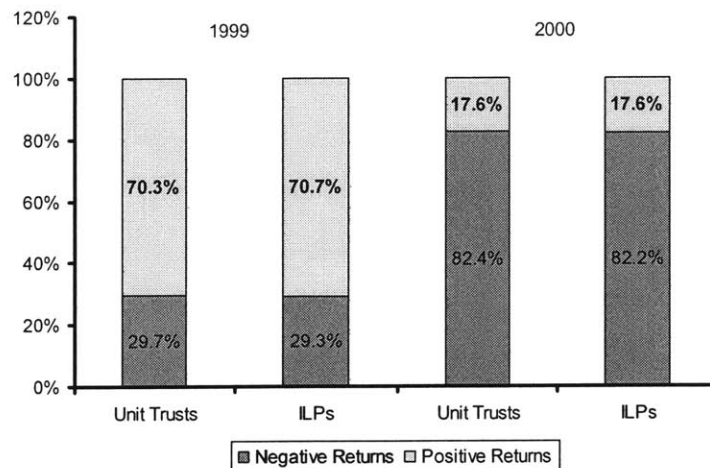
3.6.2 REITs vs. Bonds

Recently, U.S. Equity REITs were trading at a 220 basis point premium to 10-year U.S. treasury bonds. The Australian LPTs were trading at a 240 basis point premium to the Australian 10-year government bond. Over the past three years, the premium to 10-year bonds has in both countries fluctuated between 150 and 250 basis point.¹⁷

3.6.3 SREITs vs. Unit Trusts

Unit trusts have benefited greatly from the capital inflows that have been made available from the liberalization of CPF savings. However, in recent years many unit trust products have exhibited volatile returns. Figure 4 illustrates that most unit trusts and investment-linked insurance products (ILPs) achieved negative absolute returns in Q2 2000 due to their overweight exposure in the technology sector and the emerging Asian stock markets. In addition, management fees for REITs are likely to be lower than those charged by unit trust fund managers. The 92 CPF-approved unit trusts have expense ratios ranging from 0.8% to 4.0%, with a mean of 2.2%. In contrast, Australian LPTs' average management expense ratio is 75-100 basis points.

Figure 4: Absolute Performance of CPF-Approved Investment Products



Source: William Mercer

3.6.4 SREIT vs. Direct Real Estate Investment

CPF members can use their idle savings—in CPF and deposits—for direct real estate investment. But Singaporeans’ obsession with owning private property is slowly fading. While Singaporeans’ preference for owning a family home is likely to remain, the investment appeal of residential property has waned. Condominium speculation, which provided easy money in the asset bubble of the mid-1990s, has virtually vanished after the introduction of anti-speculation curbs in May 1996¹⁸. Strong capital appreciation in house prices is becoming harder to sustain as GDP growth slows from double-digit growth in the last few decades to an expected 3-5% for the next few decades. Muted capital appreciation aside, persistent negative carry can make residential real estate a poor investment, especially for retirees. Furthermore, the high opportunity cost of direct investment will likely be accentuated with the availability of SREITs, which would provide positive carry. Local investors are likely to favor the lower risk SREIT, which should provide steadier yields. REIT investors also need not contend with tenants, lease renewals and refurbishments.

GLOBAL PERSPECTIVE – REITs IN THE U.S. & AUSTRALIA

This chapter studies the historical evolution and key success factors of two of the world's most active REIT markets in the U.S. and Australia. The aim is to draw lessons for the development of the REIT market in Singapore.

4.1 REITS IN THE U.S.

REITs in the U.S. generally fall into four broad categories¹⁹:

- A. **Equity REITs** – Invest at least 75% of the assets directly in the underlying equity of real estate properties. Equity REITs develop, acquire, manage and lease institutional grade properties in almost every sector, including multifamily, industrial, office, lodging and retail. Equity REITs also invest in specialty categories such as golf courses, prisons, mini-warehouses, gas stations, parking lots, and auto dealerships.
- B. **Health Care REITs** – Invest in health care facilities such as medical office buildings, hospitals, nursing homes, and assisted living projects. Health care REITs also engage in mortgages on health care facilities.
- C. **Mortgage REITs** – Invest in and originate portfolios of mortgage securities, including commercial mortgage backed securities (CMBS) and collateralized mortgage obligations (CMOs). To be considered a mortgage REIT, it must have at least 75% of assets invested in real estate mortgages.
- D. **Hybrid REITs** – Invest in both real estate equity and real estate mortgages.

4.1.1 History Of U.S. Equity REITs

The history of U.S. Equity REITs can be traced back to the 1960s. However, it was only in 1992 (coinciding with the strong recovery of the U.S. economy) that the U.S. Equity REITs market witnessed significant growth. The U.S. Equity REIT market capitalization increased from USD\$8.7bn in 1990 to USD\$154.3bn at year-end 2001. Below is a summary of events that influenced the development of U.S. Equity REITs since the 1960s.²⁰

A. Mid-1960s

A credit crunch during this period caused the real estate and construction sector to seek alternate sources of funding. Mortgage REITs and Equity REITs market began to expand.

B. Early 1970s

The tightening of the monetary policy led to a rise in the bankruptcy of REITs, particularly mortgage REITs.

C. Early 1981

The Economic Recovery Tax Act allowed accelerated depreciation of real estate owned by partnerships and allowed investors to set off real estate investment fund losses against their personal income.

D. 1986

The Tax Reform Act of 1986 repealed many tax breaks and sharply altered the environment that had created the boom in real estate in the early 1980s.

E. Post 87

Equity REITs replaced limited partnership as the popular real estate investment vehicle that distributed 95% (90% from 2001) of taxable income, and offered higher transparency and liquidity.

4.1.2 Tax and Management Structure

The U.S. Equity REITs is governed by the Real Estate Investment Trust Act which was passed by Congress in 1960 and adopted into the U.S. Internal Revenue Code Sections 856 to 860. The intent of this Act was to apply the mutual fund concept to the real estate industry, thereby offering small investors the opportunity to hold a diversified portfolio of real estate assets. For tax purposes, both REITs and mutual funds are considered pass through entities, not corporate entities. Therefore, REITs pay no corporate income taxes and eliminate double taxation. A REIT pools investor capital and invests in a wide range of real estate properties or mortgages. To meet the Inland Revenue Service (IRS) Tax Code requirements and be exempted from taxes, they must meet the following requirements²¹:

- A. **Distribution test** – at least 90% of net taxable income (formerly 95% prior to REIT Modernization Act which was enacted in 1999) must be distributed in common and preferred dividends to shareholders. The distribution must be complete on or before the REIT’s final tax return is filed with the IRS (typically within nine months of year-end);
- B. **Asset test** – at least 75% of book value must be invested in real estate equities and/or mortgages;
- C. **Income test** – at least 75% of gross revenue must be derived from rents and/or interest from mortgages; and
- D. **Ownership test** – not more than 50% of shares can be owned by five or fewer individuals.

Through the passage of the Real Estate Investment Trust Simplification Act(“REITSA”) of 1997 (REITSA), a number of industry regulations were relaxed. Specifically,

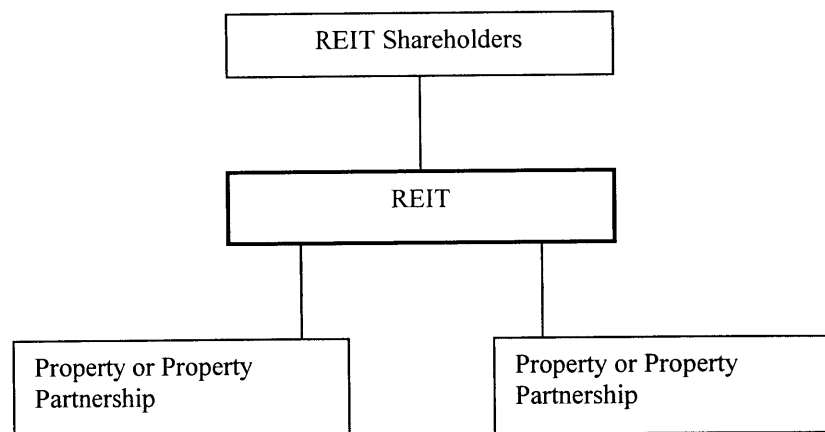
requirements relating to the sale of property held for four years or less were repealed; a REIT was previously prohibited from generating more than 30% of income from the sale of properties held for less than four years. Also, under REITSA, companies are now allowed to perform non-traditional fee-driven services at a property provided these fees do not exceed 1% of the property's gross income.²²

4.1.3 Ownership Structure

Majority of the REITs in the U.S. are self-managed. Properties within a REIT are generally contained within two types of ownership structure²³:

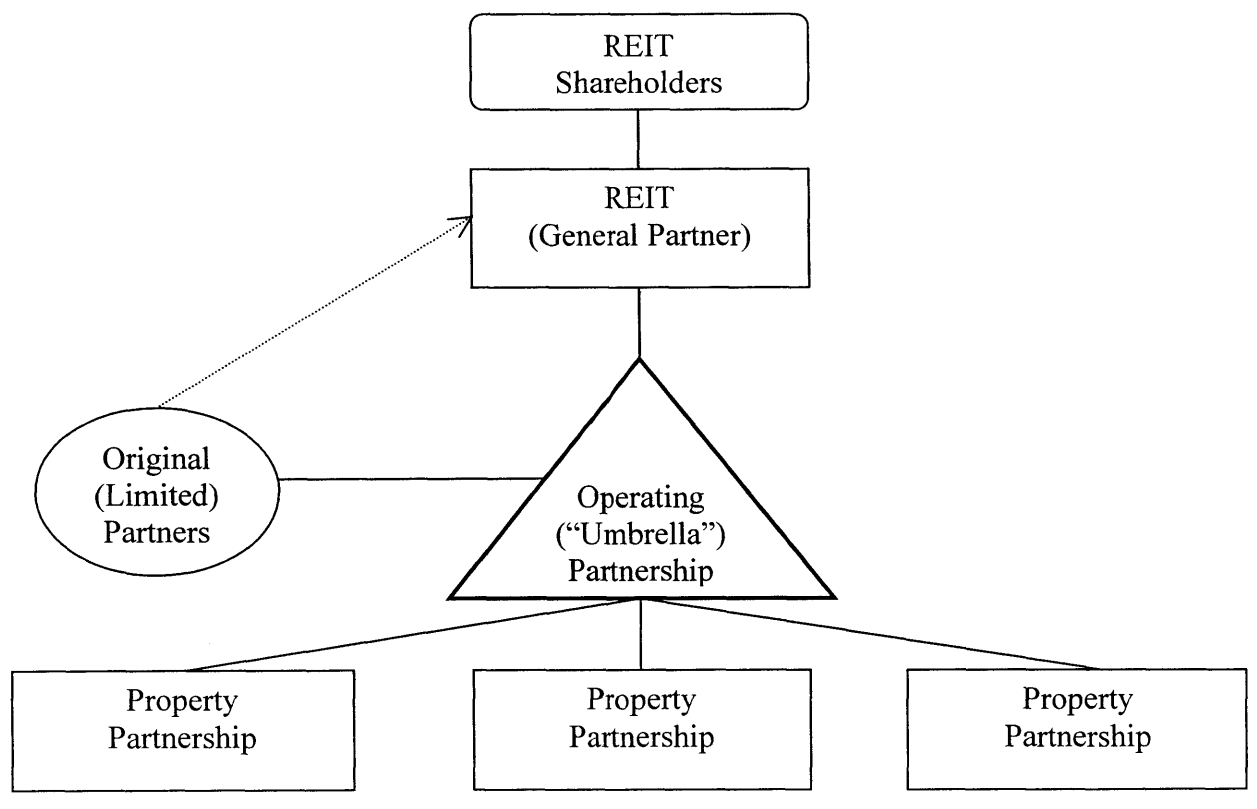
- A. **Traditional REIT** (Figure 5) - all properties are owned by the entity in which the public owns a direct interest. This structure puts public shareholders and insiders on the same footing, as each directly owns the underlying assets in a pari passu fashion with no differences in tax basis.

Figure 5: Traditional REIT Structure



B. **Umbrella Partnership REIT (UPREIT)** (Figure 6) - The underlying properties are owned in a partnership or series of partnerships. The REIT owns a general partnership interest in the operating partnerships alongside other limited partners.

Figure 6: The UPREIT Structure



The UPREIT structure was first created to help facilitate Taubman Centers' IPO, and has been employed by a large number of other companies since that time. Through this structure, initial sponsors of the REIT IPO are able to swap their current privately held interests in their properties for UPREIT units in a tax efficient manner. Without the adverse consequences of capital gains treatment for depreciated properties, private real estate entrepreneurs can now employ the UPREIT structure to monetize their real estate in a tax efficient manner. That said, the UPREIT structure does create a conflict of interest between UPREIT unit holders and public shareholders, as each contains a different tax basis in the underlying properties. REIT shareholders contain a cost basis

equal to the price they purchased their shares in the open market, while UPREIT unit holders contain a cost basis equal to their depreciated basis in the underlying properties.²⁴

4.2 REITS IN AUSTRALIA

4.2.1 Historical Background

The REIT in Australia is known as Listed Property Trust(LPT). The first LPT was General Property Trust, which listed on the Australian Stock Exchange in 1971. However, in a similar fashion to the U.S. REIT market, the sector did not witness significant growth until the early 1990s. In the 1980s, numerous real estate investment funds were established as unlisted property trusts. However, the 1987 economic crash led to a protracted decline in real estate prices with panicking investors redeeming their units from unlisted property trusts. Without market liquidity, investors experienced difficulties in withdrawing their capital from unlisted property trusts that could not sell assets to fund redemptions.

As the economy worsened, insurance companies and banks experienced difficulties in liquidating their direct real estate exposure. From the early 1990s onwards, a number of unlisted property trusts applied for listing on the Australian Stock Exchange and became listed property trusts. Over the past decade, the LPT sector's market capitalization has grown from A\$5bn in 1990 to A\$35bn in 2001, comprising approximately A\$46bn of investment grade real estate assets.²⁵

4.2.2 Tax and Management Structure

LPTs are governed by the Australia Tax Office Corporations Law. An LPT is a non-tax paying listed entity. It typically pays out 100% of its accounting profit as dividends. The dividends are taxed in the hands of the unit holder. As LPT does not pay tax, there is no

double taxation. To maintain this tax-free status, the LPT can only be a passive, collective investment vehicle and cannot undertake operational businesses. LPTs are typically externally managed by property managers such as Westfield and Lend Lease or by institutional managers such as AMP and AXA. These managers will charge a management fee based on the size of the assets.

4.3 U.S. REITs VS. AUSTRALIAN LPTs

4.3.1 Tax Transparency - A Common Key Success Factor

Based on the materials presented above, a common key success factor for the U.S. and Australian REITs is tax transparency. Hence, it is useful to understand how tax transparency works and the benefits of tax transparency.

4.3.1.1 The Concept of Tax Transparency

Tax transparency simply means that dividend distributions from the REIT are not subject to tax at the source. Instead, pre-tax dividends are paid to unit holders who will include REIT dividends as part of their wider taxable income. As such, taxation would occur at the recipient level, rather than at source.

4.3.1.2 Benefits of Tax Transparency

The key benefit of tax-transparent REITs is that they have characteristics similar to direct real estate ownership. For example, an owner of an office building would receive net rental income after deducting the expenses required to operate the building. Tax would then be payable at the marginal rate by the owner as part of its annual tax return. A REIT unit holder would have similar exposure as the investor and would receive the major portion of taxable income generated by the

REIT's real estate portfolio and would be responsible for paying tax at the marginal rate as part of the investor's annual tax return.

Another advantage of having tax transparency is a more attractive cash yield from the instrument. The REIT unit holder can easily compare a REIT yield with yields from direct investment in real estate and interest earned from bank deposits.

4.3.2 Key Differences between U.S. REITs and LPTs

Table 8 presents the salient features of the REITs market in the U.S. and Australia.

Table 8: International REIT Market Comparison

	U.S.	Australia
Market Capitalization	Over USD\$300bn	Over USD\$21.6bn
Number of Companies	300	36
Types of REITs	3 Types Equity REITs (97% of total REIT cap.) Mortgage REITs (1% of total REIT cap.) Hybrid REITs (2% of total REIT cap.)	Mainly equity REITs that are known as LPTs
Dividend yield (%)	7.0%	7-8%
Dividend payout	Pay dividend of at least 90% of the REIT's taxable income	Pay dividend of 100% of the LPT's taxable income
Average yield gap	161 bps over past 5 years	110 bps over past 5 years
Leverage (debt to total assets) (%)	Around 40%	20-30%
Shareholding structure	Minimum 100 shareholders No more than 50% of shares held by 5 or fewer individuals	Minimum 300 shareholders No more than 75% of share held by 20 or fewer individuals
Who invest	50% retail and 50% institutions	40% retail and 60% institutions
Management Structure	Majority internally managed	Externally managed
Valuation focus	Yield FFO (funds from operations i.e. net income plus real estate depreciation) CAD (cash available for distribution, i.e. recurring cash flow available for distribution) NAV (net asset value)	Yield NAV IRR
Taxation	Not taxed at source; corporate tax 35%	Not taxed at source; corporate tax 34%
Governed by	Internal Revenue Code(IRC) RE trust Act 1990	Aust Tax Office Corporations Law

Source: UBS Warburg

The key differences between the two markets include:

A. Management Structure

U.S. Equity REITS are mostly internally managed while Australian LPTs are mostly externally managed. The latter structure is favored by Australian institutions because the investor protection mechanisms that are built into the trust deed allow investors to vote out managers in cases of poor performance. The trust deed also requires unit holders' approval for related-party transactions.²⁶

B. Dividend Payout

U.S. Equity REITs are required to distribute 90% of taxable income as dividend while Australian LPTs are required to distribute 100% of taxable income. The latter is viewed as being more efficient as they tend to distribute 100% of accounting income in order to maximize yield to investors.²⁷ In contrast, U.S. Equity REITs distribute 90% of taxable income, which may as a consequence of tax deductions, represent 60% of accounting income. While LPTs distribute 100% of their taxable income, the downside is that they will have little funds from their operations for future growth via acquisitions. Instead they will have to tap the public market for more funds by issuing more units in order to fund any future acquisitions. The issue of more units could potentially lead to a dilutive effect on existing unit holders.

C. Accounting and Tax

The U.S. Generally Accepted Accounting Practice(GAAP) requires that investment real estate be depreciated over its useful life.²⁸ Though depreciation of the property value over time is not an expense, the IRS allows depreciation to be deducted from the taxable income. Such deduction lowers the dividend payout amount to unit holders. The net balance of accounting profit can be retained for future growth opportunities, provided the dividend payout requirements are met. Given that the tax authorities require 90% of

taxable income to be distributed, the difference between taxable income and accounting income can vary significantly when building depreciation is allowed as a tax-deductible item.

As illustrated in Table 9, the dividend payout as a percentage of Funds From Operation(FFO) is lower in the U.S. as compared to that of Australia (as a percentage of net income—FFO equivalent). This is a function of two things:

- i. Higher levels of tax deductibility (especially building depreciation) in the U.S.—as discussed above.
- ii. Lower dividend payout requirements in the U.S. at 90% of taxable income—compared with the Australian LPT requirement of 100%.

Table 9: Dividend Distribution Comparison between U.S. Equity REITs and Australian LPTs

	U.S. Equity REITs	Australian LPTs
Funds from Operations (FFO)	100	-
Net Income	-	100
Less Depreciation	30	0
Taxable Income	70	100
Payout Restrictions	90%	100%
Minimum Dividends	63	100
Payout of FFO/ Net Income	63%	100%
Retained Earnings	7	0

REGULATORY FRAMEWORK FOR REITs IN SINGAPORE

5.1 PROPERTY TRUST GUIDELINES

The MAS first issued guidelines- Property Trust Guidelines- on the establishment of SREITs on 14 May 1999. The guidelines were subsequently revised on 29 Nov 2000. The Property Trust Guidelines stipulate that a REIT must be externally managed and require that a trustee holds the trust's assets for the benefit of unit holders. The Property Trust Guidelines impose, amongst other things, a restriction on the types of investments the trust may hold (being primarily property), limit the level of borrowing to a maximum of 25% of total asset value and provide a framework for dealing with "interested party transactions" (as defined in the Property Trust Guidelines).

Table 10 gives a summary of the key characteristics of the Property Trust Guidelines. (Please refer to Appendix A for the Property Trust Guidelines).²⁹

Table 10: Current Legal & Tax Structure in Singapore

Legal	Tax
<ul style="list-style-type: none"> • Must be listed on Singapore Exchange • May invest in property in or outside Singapore. But not more than 20% of total assets can be invested in uncompleted non-residential property developments in Singapore or uncompleted property developments outside Singapore. 	<ul style="list-style-type: none"> • Property fund will be taxed as ordinary companies or trusts in accordance with normal tax principles • Unit holders will claim tax credits in accordance with normal practice <ul style="list-style-type: none"> - Resident investors will be taxed at their marginal tax rates (i.e. no double taxation) - Non-resident investors will receive net dividend but are not entitled to tax credits in Singapore. Whether they will be able to claim tax credits in their home country will depend on the availability of unilateral or multilateral tax credits.
<ul style="list-style-type: none"> • At least 70% of total assets in real estate and real estate related assets • Cannot buy vacant land or participate in development process directly with the exception of buying real estate to be built on vacant land that has been approved for development • Cannot borrow more than 25% of the total value of assets • Manager must be a public company or incorporated in Singapore under the Company Act • A full valuation of each of the SREIT's property assets must be conducted by an appraiser at least once a year • An SREIT's annual report must disclose all relevant details including the latest valuations, the location of property assets, rentals received, occupancy rates and lease structure. Net Tangible Asset per share at the beginning and end of the fiscal year must also be disclosed 	<ul style="list-style-type: none"> • Anti-speculation measures introduced in 1996 will apply to property fund transactions • Stamp duties will apply to property fund transactions (including establishment of REIT) • No "return of capital" component in distribution

Source: MAS

5.2 KEY DIFFERENCES BETWEEN SINGAPORE AND U.S. REIT REGULATIONS

The key differences between Singapore and U.S. REIT regulations are reflected in the table below:

Table 11 Key Differences between Singapore and U.S. REIT Regulations

Policy	Singapore	U.S.
Treatment of Corporate Taxes	<ul style="list-style-type: none"> • Taxed at the corporate level with tax credits issued to unit holders when dividends are paid. • Unit holders who are non-residents will receive net dividends. 	<ul style="list-style-type: none"> • A pass-through entity, subject to a 90% dividend payout, where tax rates are based on an individual's marginal tax rate.
Asset Test	<ul style="list-style-type: none"> • At least 70% of total assets must be invested in real estate³⁰ and real estate related assets³¹, subject to a minimum of 35% of total assets must be invested real estate. 	<ul style="list-style-type: none"> • At least 75% of book value must be in real estate assets, cash or government securities.
Revenue Test	<ul style="list-style-type: none"> • Investment into vacant land and mortgages are not permitted. 	<ul style="list-style-type: none"> • More than 75% of gross revenue must be derived from rents and or mortgage interests or gains from sale.
Ownership Test	<ul style="list-style-type: none"> • Subject to SGX listing requirements if fund is listed. 	<ul style="list-style-type: none"> • Not more than 50% of shares can be owned by five or fewer individuals.
Management Structure	<ul style="list-style-type: none"> • External Management 	<ul style="list-style-type: none"> • Internal Management

5.3 ISSUES CONCERNING SREIT GUIDELINES

A. Treatment of Corporate Taxes

Currently, SREITs are not tax exempt. But in practice, there is no double taxation. At the corporate or trust level, SREITs' net income is subject to corporate tax. The corporate tax paid by SREITs is then passed on as tax credits to their unit holders when the income is distributed as dividends. The unit holders can use the tax credits to offset their other taxable income. SREIT holders will be taxed on their dividends at their marginal tax rates. Non-resident investors will receive net dividends, but are not entitled to tax credits in Singapore. Whether they will be able to claim tax credits in their home country will depend on the availability of unilateral or multilateral tax credits.

In contrast, REITs in the U.S. and Australia are not subject to corporate tax, provided that at least 90% (for U.S.) and 100% (for Australia) of taxable income is distributed to unit holders. There is only one level of taxation, i.e., distributed income is taxed at the unit holders' marginal tax brackets on the receipt of dividends.

From a cash flow perspective, the tax paid by unit holders is generally the same in both instances, whether at the marginal tax rate or in claiming back the tax credits from the dividends taxed at source. However, one disadvantage concerning the tax treatment in Singapore is that unit holders without any taxable income will not be able to utilize the tax credits.

B. Lobbying for Exemption of Stamp Duty

In addition, stamp duty will have to be paid on the transfer of assets into SREITs. The industry is lobbying for exemptions to facilitate the launch of SREITs.

C. 25% Leverage Limit

Another area of concern is the low allowable leverage ratio of SREITs. The Property Trust Guidelines allow SREITs to borrow up to only 25% of their total asset. If a SREIT has already hit the borrowing limit (by MAS standard), it would be impossible for the SREIT to grow via acquisitions. In this case, it would have to raise cash by issuing new shares. As this is restrictive to the growth potential of a SREIT, the government may want to review this leverage limit going forward. Higher leverage need not necessarily increase the risk profile of SREIT substantially, especially if interest coverage is adequate. SREIT cash flows are often backed by steady rental income.³²

D. External Management

Under existing MAS guidelines, SREITs have to be externally managed, as in Australia. Whilst we see the benefit of higher transparency in an externally managed REITs, the interests of the REIT manager and the REIT itself may not be aligned. As such, there must be incentives for a REIT manager to maximize the value of the REIT, meaning that the management fees should be linked to the performance of the fund. In Australia, LPT managers are paid based on a percentage of asset value, which might not go down well with investors in Singapore as property values are much higher in Singapore as compared to that of Australia.³³

5.4 **FUTURE DEVELOPMENTS**

Although the authorities have yet to make any official pronouncements with respect to the issues highlighted in the earlier section, recent regulatory moves have been encouraging. The MAS now permits foreign property funds to borrow in Singapore dollars to fund the acquisition of commercial property.³⁴ The move was aimed at closing the gap between rental yields and cost of debt by allowing foreigners to access cheap domestic funds. Given the government's widely publicized push to fully liberalize its financial sector, as well as the need for SREITs, the industry believes that the government is likely to revise the tax treatment and the leverage limit of SREITs.

CHAPTER 6

SINGMALL PROPERTY TRUST

6.1 INTRODUCTION TO SINGMALL PROPERTY TRUST

Last November, the first SREIT, known as Singapore Property Trust (SPT), was supposed to be listed. The issue was sponsored by CapitaLand with an intended offering size of S\$740 million (USD\$411 million), of which S\$530 million (71.6%) was to be floated publicly. The initial offer yield was estimated to be 5.75%.³⁵ The listing was ultimately aborted, as subscription fell short of the group's target.

The SPT, which was modeled closely on the Australian Listed Property Trust (LPT), contained three shopping malls, details of which are shown in Table 12.³⁶

Table 12 SPT's Property Portfolio

Property	Book Value (S\$m)	Gross Area(GLA) (sq ft)	Lettable	% of portfolio
Tampines Mall	409	314,441		45.7
Junction 8	295	250,474		33.0
Funan IT Mall	191	250,018		21.3
Total	895			

Source: CapitaLand

SPT issued 740m units, of which 28% were issued to CapitaLand and the balance to institutional and retail investors. With a market capitalization of S\$740m at the offer price of S\$1, and a 72% free float, SPT ranked third among Singapore property stocks in terms of free float capitalization (after CapitaLand and City Developments).

6.2 STRENGTHS OF SPT

A. Falling interest rates

SPT's offer yield of 5.75% was 277 basis point above the Singapore long term government bond yield of only 2.98%. Given the low and falling interest rates during the offer period, SPT was an attractive, high-dividend equity alternative in a volatile market environment.

Figure 7: Government Bond Yield Curve



Source: Bloomberg

B. SPT vs. Local Securities or Equities

The 5.75% for FY02 yield also compared well against other domestic securities, including high dividend-paying equities during the period of offer. A comparison of SPT against larger, more well-known high-yield stocks listed on the Singapore Stock Exchange is presented in Table 13. All yields specified in Table 13 are stated gross.

Table 13: Comparative dividend yields

	Price (S\$)	FY02 yield(%)
Comfort Group	0.62	5.3
Delgro Corp	2.40	3.5
Sembcorp Marine	0.87	5.5
Singapore Exchange	1.01	4.0
Singapore Land	3.42	2.9
Singapore Press Holdings	15.90	4.4
SMRT	0.745	3.8
SPT	1.00	5.75

Source: ING Barings

C. Tax Transparency

SPT obtained Inland Revenue Authority of Singapore (IRAS) exemption from deducting tax at source. This, however, was applicable to only tax-resident Singapore citizens or Singapore incorporated corporations that were unit holders. Other unit holders would receive dividends net of 24.5% tax deducted at source.

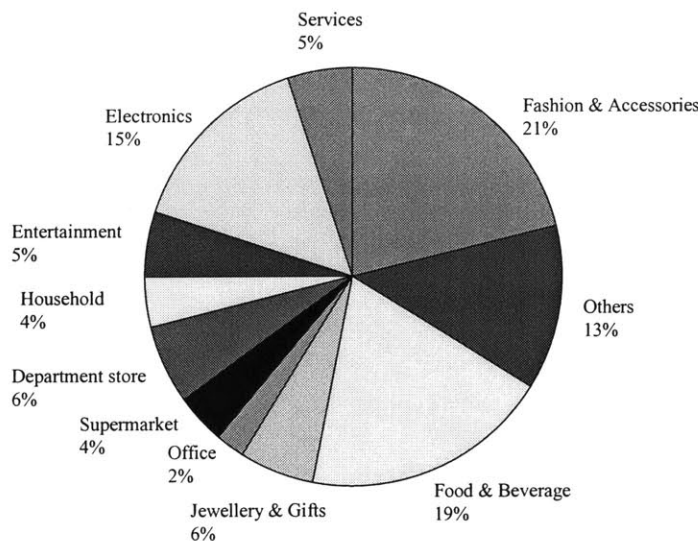
D. Exposure to Singapore retail

The positive factor going for SPT was the purity of its business. It provided pure exposure to the retail sector which was not currently available among other listed property stocks in Singapore. Two of the malls, Tampines Mall and Junction 8, are suburban malls that possess large catchment areas, while Funan IT Mall occupies an established electronics equipment niche. Suburban retailing (away from the well known prime Orchard Road area) had remained robust despite the economic downturn, as evidenced by the 100% occupancy levels at all three malls.

The portfolio was well diversified, with over 440 lease agreements in total, and the largest single retail subsector generating 21% of SPT's base rental income (fashion and accessories). The Funan IT Mall had the most concentrated tenant mix, focusing on electronics equipment retailing, at 50% of that property's total. The 10 largest tenants contributed 25.6% of SPT's base rental income, with Isetan (the largest) generating 3.8%.

37

Figure 8: Rental Income by Tenant Type



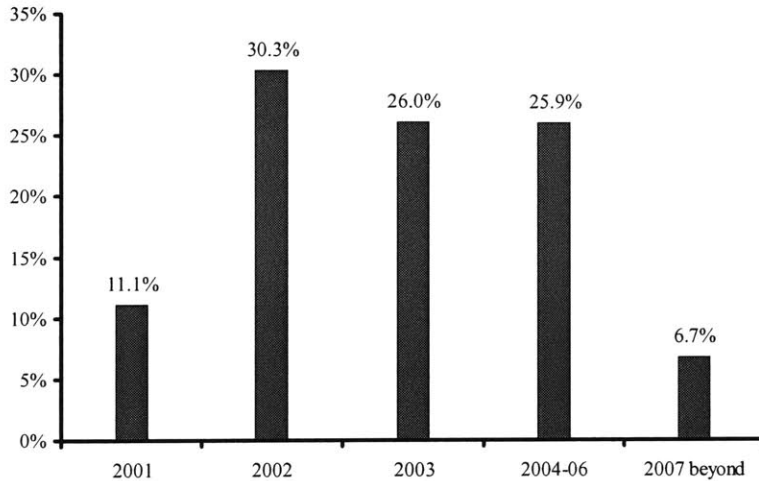
Source: CapitalLand

6.3 WEAKNESSES OF SPT

A. Relatively short asset duration

Given the typical three-year rental cycle in Singapore, SPT's weighted lease term by base rental income was only two years, compared with Australian equivalents that had much longer durations (four to six years). This could be an unattractive characteristic in a declining rental rate trend (the most likely upcoming scenario). SPT's management was attempting to negotiate longer lease terms (which would also typically be desired by tenants), but the risk was that to lock tenants in for longer in uncertain times, SPT would need to offer better terms. Although recent renewals offered some evidence to disprove this risk factor (even post-11 September), there was still possible pressure on rental rates, especially in 2003 when many of the leases expire.

Figure 9: SPT's Lease Expiry Profile



Source: Capitaland (weighted by base rental income)

B. Robust yields?

We believe that SPT's yields were generally robust. In its prospectus, SPT projected 5.75% and 6.05% earnings yields before tax in 2002 and 2003, respectively. The projections incorporated a number of buffers for vacancy, rental turnover income, and most significantly, an overestimate of the likely interest cost payable by SPT. The company utilized an assumption of a 4.0% interest charge on its S\$150m transferable loan facility (part of total borrowings of S\$198m), whereas a more appropriate rate is between 3.0% and 3.2% pa. This difference alone was enough to boost SPT's net operating income before tax by more than S\$1.2m, representing a buffer of at least 17 basis point. The company believed that in an unspecified worst-case scenario its net operating yields before tax would fall to 5.0%.

6.4 FACTORS CONTRIBUTING TO FAILURE OF SPT

The aforesaid paragraphs seemed to justify that SPT was a worthwhile investment to be made simply looking at the attractive dividend yield of 5.75%. Why was it that there was not enough interests in this much-awaited new investment instrument? Based on interviews with industry professionals, the following issues have been cited as possible reasons for the unsuccessful listing of SPT.

A. Pricing Unattractive on a Total Return Basis

The first, and probably most important, factor was pricing. The industry practitioners have stated that the offered 5.75% yield, while high in a Singapore context, was not attractive enough. The concern was not only on the initial yield, but also pricing from a total returns perspective. They compared the SPT with the Australian listed property trusts, which offered 11-12% total returns (yield + dividend growth). They were not convinced about the SPT's near term growth potential, as the outlook for the Singapore retail market, following September 11, was fairly dreadful at that time.

B. Property Valuation Deemed Aggressive

Another concern cited was the overly aggressive valuation of the assets injected into the SPT. The three shopping malls that were to be injected by CapitaLand were revalued at S\$100 million higher than the previous year, at a time when property prices in Singapore were set to decline due to the economic downturn. Moreover, the SPT was priced at a 2.7% premium to an already high Net Asset Value (NAV); hence, investors were concerned about the downside risks on valuation.

C. Lack of REIT Experience

Prior to the IPO launch, Lend Lease was negotiating with CapitaLand to be the external manager of the SPT. Two months before the scheduled listing, Lend Lease decided to depart from the deal. The loss of Lend Lease was a setback, leaving some doubts as to whether CapitaLand had the experience to manage a REIT.

D. Distribution

Distribution was also cited as a critical issue for the SPT offering. It was skewed primarily to institutional investors, and emphasized a few large orders from strategic investors. The portion allocated to retail investors appeared to be small (it was estimated that only 8% of the final order came from retail demand). In retrospect, it also seems that the marketing of this new asset class to domestic retail investors was not sufficient, thus adversely affecting retail demand for the issue.

As this was a new instrument, investors were uncertain about the performance post listing given the above issues.

E. Central Provident Fund (CPF) Trustee Status

Another reason cited was that the SPT issue was not granted CPF trustee status, and therefore, retail investors were not able to use their CPF savings to invest in the SPT. Given that a substantial portion of CPF members' monies go to the mortgage financing or purchase of real estate property, the government was concerned that there was an over exposure of CPF monies in real estate related transactions.

6.5 FUTURE INTERESTS IN SREITs

Despite the failure of the first REIT launch in Singapore, several other listed developers have expressed interest in sponsoring an SREIT in the near future.

A. Keppel Land

Keppel Land, for instance, announced its intention to divest part of its investment property portfolio either through direct sale, asset securitization, or an SREIT issue.³⁸

Keppel Land's plan to divest its largely office property portfolio via an SREIT issue may not be feasible at this moment as office property yields, currently estimated at 4%, are probably not attractive enough for an SREIT listing. Remember that CapitaLand's planned SPT launch was offering a dividend yield of 5.75-6.05%.

B. Centrepoint Properties

Centrepoint Properties also considered a retail REIT offering that may include its two flagship properties, Centrepoint Shopping Mall on Orchard Road and Causeway Point in the northern suburbs.³⁹

6.6 KEY INITIATIVES BY SREITs SPONSORS

One of the key initiatives by the SREIT sponsors is to appeal to the regulators to ease the restrictions on Singaporeans investing in the trust. This is seen as a key requirement for getting retail investors interested. Failure to ease the restrictions could mean taking a separate route, which would see the sponsors relying entirely on institutional or sophisticated investors, thereby limiting the potential demand pool. Hence, the marketing effort for the SPT would be a function of the structure. Another initiative is to convince regulators to lift the cap on the leverage for the SREIT, from 25% currently. This is to provide financing opportunities for any future acquisitions.

6.7 OUTLOOK FOR SREITs

A. SREIT Market Still Has Potential as a Capital Market for Developers

On the supply side, despite the SPT debacle, the prospects of SREITs remain positive. The SREIT market in Singapore still has the potential to provide an avenue for developers to divest their large, chunky investment properties. However, the crucial issues mentioned above have to be ironed out first before the first SREIT issue is to come onto the market.

B. Public Expectation of SREITs Remains High

On the demand side, the immediate reaction by media, such as *Finance Asia Magazine* and *Business Times*, was focused primarily on pricing and valuation. If the concerns surrounding the SPT, such as pricing, valuation, and distribution, could be properly addressed, the next SREIT would have a good chance of attracting both institutional and retail demand. As mentioned earlier, when structured properly, REITs could offer highly attractive risk-adjusted returns over time.

CONCLUSION

In spite of the failure of the first REIT launch in Singapore, we believe that the business case for establishing an SREIT remains compelling given the following reasons:

On the supply side, there is a strong impetus for real estate owners to divest their properties since the Asian Economic Crisis given the capital intensive and low return nature of the assets. In addition, banks and other non-real estate companies are under increasing pressures to divest their non-core assets to concentrate on their core businesses. REIT is a more attractive divestment vehicle when compared with other vehicles such as direct outright sale and asset securitization

On the demand side, attractive conditions for the establishment of an SREIT are also present. Firstly, the recent liberalization of the investment rules for the Central Provident Fund could unlock approximately S\$9 to 10bn of funds into SREITs in the long term. In addition, the large base of retail deposits in Singapore (estimated to be S\$138bn as of May 2000) could generate substantial demand for SREITs. This is because SREITs offer an attractive yield of 5 to 6% as compared to the low interest rates (ranging between 0.35 to 0.81%) offered by fixed and savings deposit currently. This low interest rate environment is expected to prevail in the short to medium term, thus making SREIT an even more compelling investment instrument for retail deposits.

With regard to the legal and tax framework for the SREIT, it is modeled closely after the regulatory framework for Australia's LPT and is largely in line with international best practices. The only component that is missing is full tax transparency for all investors, which is critical for yield-based instruments like REITs.

The case study on the failure of the launch of CapitaLand's SingMall Property Trust – the first REIT in Singapore – reveals that the key factors contributing to the failure namely pricing, valuation and distribution were specific to the trust itself and have little relationship with the broader market conditions such as supply, demand and regulation.

ENDNOTES

¹ The MAS is the defacto central bank and the integrated financial regulator supervising the banking, insurance, securities and futures industries in Singapore.

² Steven Pearlstein. “Understanding the Asian Economic Crisis.” Asian Economies Report 18 Jan 1998: A32.

³ Paul Krugman. “What happened to Asia?” Article obtained from Nouriel Roubini’s Global Macroeconomic and Financial Policy Website (<http://pages.stern.nyu.edu/~nroubini/asia/>) Jan 1998.

⁴ The Asian Tigers include Japan, the “four tigers:” Hongkong, South Korea, Singapore and Taiwan; and the “emerging tigers:” Indonesia, Malaysia and Thailand.

⁵ Information obtained from website of MAS (www.mas.gov.sg).

⁶ Asset securities are typically based on pools of commercial mortgages. Different classes of securities are usually issued from the same underlying pool. Some classes are more risky than others, and different classes have different maturities. This allows a variety of risk and return patterns to be created for different classes of securities based on the same underlying pool of mortgages. In this way, investors with different risk profiles and investment horizons can be served. (for further information, please see David Geltner and Norman G. Miller)

⁷ Personal Interview.

⁸ Interview with UBS Warburg.

⁹ Tan Suang Tsan. “Singapore Property – Recovery, Restructuring and REITs.” Saloman Smith Barney Equity Research Report 1 Mar 2002: 20.

¹⁰ Interview with UBS Warburg.

¹¹ Data obtained from website of CPF (www.cpf.gov.sg).

¹² Data obtained from website of DBS (www.dbs.com.sg).

¹³ Data obtained from website of CPF (www.cpf.gov.sg).

¹⁴ Interview with UBS Warburg.

¹⁵ Data from www.dbs.com.sg

¹⁶ Interview with UBS Warburg.

¹⁷ Interview with UBS Warburg.

¹⁸ Singapore Government introduced anti-speculation measures in May 1996 to stabilize market prices. These measures are: higher cash down payment (increase from 10% to 20%), higher income tax rates on property sales made within three years of purchase and more land will be released for private housing development, commercial-office and retail developments.

¹⁹ William B. Brueggeman and Jeffrey D. Fisher. Real Estate Finance and Investment. Boston: McGraw-Hill 2001, 11th Edition: Pg 565-587.

²⁰ Richard T. Garrigan and John F.C. Parsons. Real Estate Investment Trusts – Structure, Analysis, and Strategy. McGraw-Hill 1998. Pg 3-30.

²¹ Ibid, pg 31-82.

²² Morgan Stanley Fifth Annual REIT Primer Seminar, Jan 2002.

²³ See Richard T. Garrigan and John F.C. Parsons etc. Pg 86-87.

²⁴ Ibid, pg 53-57.

²⁵ Merrill Lynch (AL). “Listed Property Trusts –Upwards and Onwards.” 20 Feb 2001.

²⁶ Interview with UBS Warburg.

²⁷ Ibid.

²⁸ The IRS depreciable life for residential and non-residential commercial buildings was 27.5 and 39 years respectively as of the late 1990s.

²⁹ www.mas.gov.sg

³⁰ The definition for “real estate” is provided in the SREITs Guidelines which is attached in Appendix B.

³¹ The definition for “real estate related assets” is provided in the SREIT Guidelines which is attached in Appendix B.

³² Personal interview.

³³ Interview with UBS Warburg.

³⁴ www.mas.gov.sg

³⁵ Singmall Property Trust Prospectus dated 29 Oct 2001.

³⁶ Ibid.

³⁷ *ibid.*

³⁸ Salomon Smith Barney Research Report “Keppel Corporation –Undervalued Growth and Restructuring Story”. 1 Feb 2002

³⁹ JP Morgan Research Report. “Asian REITs Update”. 14 May 2002

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Appendix A - Guidelines for Property Trusts

1 Scope and Definitions

1.1 These Guidelines regulate only property trusts targeted at the general public. They do not regulate, for instance, private equity funds investing in real estate. Nor do they regulate property funds that are established as companies, which are governed by the Guidelines for Property Funds (Established as Companies) in Singapore, issued by MAS on 14 May 1999 (and last updated on 29 November 2000).

1.2 For the purpose of these Guidelines:

- a) "Property trust" means a unit trust that invests or proposes to invest (within 24 months from the close of the first launch/offer) at least 35% of its deposited property in real estate. It may or may not be listed on the Singapore Exchange ("SGX"). An investment in real estate may be by way of direct ownership or a shareholding in an unlisted company whose sole purpose is to hold/own real estate.
- b) "Real estate-related assets" means listed or unlisted debt securities and listed shares of or issued by property companies, mortgage-backed securities, other property funds, and assets incidental to the ownership of real estate (e.g. furniture).
- c) "Cash equivalent items" means instruments or investments of such high liquidity and safety that they are as good as cash.
- d) "Deposited property" means the value of the fund's total assets based on the latest valuations.

2 The Trustee

2.1 A property trust, whether listed or unlisted, must appoint an independent trustee approved by the Minister for Finance under section 110 of the Companies Act.

2.2 For the purpose of para 2.1, a trustee is considered independent only if it does not have a relationship with the property trust's manager which, in the opinion of the MAS, would interfere with the exercise of proper judgement in carrying out its duties as a trustee.

3 The Manager of a Property Trust

3.1 Every property trust must appoint a manager.

3.2 The Manager must be a public company and be incorporated in Singapore under the Companies Act.

3.3 The Manager must:

- a) i) have at least 5 years of experience in managing property funds; or
ii) appoint, with the approval of the Trustee, an adviser(s) who has/have at least 5 years of experience in investing in and/or advising on real estate; or
iii) employ persons who have at least 5 years of experience in investing in and/or advising on real estate; and
- b) be one who can reasonably be expected to -
 - i) conduct its affairs, in relation to the property trust, honestly, fairly, professionally and with integrity; and
 - ii) exercise due care and diligence in fulfilling its responsibilities to the property trust; and
 - iii) have adequate safeguards against potential abuses, including those arising from conflicts of interests; and
- c) if he undertakes in the course of managing the property trust, the management of a portfolio of securities for the purpose of

investment -

- i) hold an Investment Adviser's license issued by MAS under the Securities Industry Act; or
- ii) be a bank licensed under the Banking Act.

Revised 29 Nov 2000

3.4 Where the Manager has appointed an adviser pursuant to para 3.3(a)(ii), that adviser need not be independent of the Manager, and may act as agent in seeking out buyers/sellers of real estate or in managing the trust's real estate assets. However, where the adviser has been appointed as the marketing agent for a property, that adviser may recommend the property trust to purchase that property only if:

- a) the adviser has disclosed to the Manager that it is the marketing agent for that property; and
- b) the adviser is not related to the Manager in a manner described in para 5.7(f).

3.5 Where a commission or fee is paid by the property trust to the adviser in its capacity other than as adviser, such commission or fee paid must not be at more than market rates.

4 Diversification of Investments

Unless it is stated clearly in the prospectus that the property trust will not have a diversified portfolio of real estate, a property trust must be reasonably diversified in terms of the type(s) of real estate (e.g. residential/commercial/ industrial), location/country and/or the number of real estate investments, as appropriate, taking into account the type and size of the trust, its investment objectives, and the prevailing market conditions.

5 Interested-Party Transactions

5.1 A property trust may, at the first launch/offer of the trust and any time after 12 months from the first launch/offer of the trust,

- acquire assets from or sell assets to interested parties; or
- invest in securities of or issued by interested parties¹,

if the following requirements are met:

- a) adequate disclosures are made in the prospectus (if it is at the first launch/offer of the property trust) or circular (if it is during the life of the property trust), stating -
 - i) the identity of the interested parties and their relationships;
 - ii) the details of the assets to be acquired or sold, including a description of these assets and location of the real estate assets;
 - iii) the prices at which these assets are to be acquired or sold;
 - iv) the details of the valuations performed (including the names of the valuers, the methods used to value those assets and the dates of the valuations) and their assessed values;
 - v) the current/expected rental yield (if any);
 - vi) the minimum amount of subscriptions to be received, if the transaction(s) is/are conditional upon the property trust receiving the stated amount of subscriptions; and
 - vii) any other matters that may be relevant to a potential investor in deciding whether or not to invest in the property trust or that may be relevant to a unit-holder in deciding whether or not to approve the proposed transaction(s);
- b) for transaction(s) entered into at the first launch/offer of the property trust, the property trust must have entered into

agreements to buy those assets at the prices specified in sub-para (a)(iii) from the interested parties. If the transaction(s) is/are conditional upon the property trust receiving a stated minimum amount of subscriptions, the agreements should reflect this;

- c) an independent valuation of each of those real estate assets, using both the discounted cash flow analysis and comparable property analysis, has been conducted in accordance with paras 8.1 to 8.8. Where the valuer uses only one of the above methods, he must explain why the other method was not used as well; and
- d) each of those assets is acquired from the interested parties at a price not more than the assessed value under sub-para (a)(iv), or sold to interested parties at a price not less than the assessed value under sub-para (a)(iv).

Revised 29 Nov 2000

5.2 In addition to para 5.1, a property trust that acquires assets from or sell assets to interested parties during the life of the trust after 12 months of the launch/offer of the trust must:

- a) where the transaction is equal to or greater than 3% of the property trust's net asset value ("NAV"), announce³ the transaction immediately; or
- b) where the transaction is equal to or greater than 5% of the property trust's NAV, obtain a majority vote at a unit-holders' meeting and announce the transaction immediately. A person who has an interest, whether commercial, financial or personal, in the outcome of the transaction, other than in his capacity as a unit-holder, will not be allowed to vote on the resolution approving the transaction. There must be an opinion rendered by an Independent Expert stating whether or not the transaction is on normal commercial terms and whether the transaction is prejudicial to unit-holders, based on an assessment of the impact of the transaction on the property trust on an overall basis. The Independent Expert should also draw the unit-holders' attention to any possible disadvantages of the transaction.

Revised 29 Nov 2000

5.3 For the purpose of para 5.2, the value of all transactions with the same interested party³ during the current financial year should be aggregated. If the aggregate value of all transactions with the same interested party during the current financial year is:

- a) equal to or greater than 3% of the property trust's NAV, the requirement in para 5.2(a) will apply to the latest transaction and all future transactions entered into with that interested party during that financial year; or
- b) equal to or greater than 5% of the property trust's NAV, the requirements in para 5.2(b) will apply to the latest transaction and all future transactions entered into with that interested party during that financial year.

Revised 29 Nov 2000

5.4 For the purpose of paras 5.1 to 5.9, the agreement(s) to buy or sell the assets must be completed:

- a) where the interested-party transaction is entered into at the first launch/offer of the property trust, within 6 months of the close of the first launch/offer; or
- b) where the interested-party transaction is entered into after 12 months from the first launch/offer and:
 - i) the transaction is less than 5% of the property trust's NAV, within 6 months of the date of the agreement; or
 - ii) the transaction is equal to or greater than 5% of the property trust's NAV, within 6 months of the date of unit-holders' approval referred to in para 5.2(b); or
- c) where there are more than one interested-party transaction entered into during the current financial year and the latest transaction triggers the 5% threshold referred to in para 5.3(b), within 6 months of the date of unit-holders' approval in respect of that latest transaction.

Revised 29 Nov 2000

5.5 An Independent Expert for the purpose of paras 5.1 to 5.9 must:

- a) not receive payments of more than \$200,000 aggregated over the current financial year from the Manager, adviser or other party/parties whom the property trust is transacting with. For the avoidance of doubt, this does not include fees paid by the property trust to the Independent Expert for rendering an opinion on the interested-party transaction(s);

- b) not be a related corporation⁴ of or have a relationship with the Manager, adviser or other party/parties whom the property trust is transacting with which, in the opinion of the Trustee, would interfere with the Independent Expert's ability to render an independent and professional opinion on the fairness and reasonableness of the transaction(s);
- c) disclose to the Trustee any pending business transactions, contracts under negotiation, other arrangements with the Manager, adviser or other party/parties whom the property trust is transacting with and other factors that would interfere with the Independent Expert's ability to render an independent and professional opinion on the fairness and reasonableness of the transaction(s). The Trustee shall then take such disclosure into account when deciding whether the person concerned is sufficiently independent to act as the Independent Expert for the interested-party transaction(s); and
- d) have the necessary expertise and experience, in the opinion of the Trustee, to form an opinion on the fairness and reasonableness of such transactions.

Revised 29 Nov 2000

5.6 Paras 5.1 to 5.9 do not prohibit a property trust from engaging an interested party as property management agent or marketing agent for the trust's properties provided that any fees or commissions paid to the interested party are at not more than market rates.

5.7 For the purpose of these Guidelines, an "interested party" is defined to include:

- a) the sponsor/promoter of the property trust (if different from the Manager)⁵ ;
- b) the manager of the property trust;
- c) the adviser to the property trust;
- d) the trustee of the property trust;
- e) a director, other than an independent director, of the sponsor/promoter, Manager or adviser (or an associate of any such director); or
- f) in respect of the sponsor/promoter, Manager or adviser -
 - i) its ultimate/immediate holding company;
 - ii) its subsidiary;
 - iii) its associated company;
 - iv) its fellow subsidiary;
 - v) where it is an associated company of another company, say, Company X - a subsidiary of Company X⁶ ;
 - vi) its fellow associated company;
 - vii) an associated company of its immediate holding company;
 - viii) a subsidiary of the entity in sub-para (ii), (iv) or (v); or
 - ix) an associated company of the entity in sub-para (ii), (iv) or (v).

5.8 In para 5.7(e), an "associate of any such director" means:

- a) any member of his immediate family⁷ ;
- b) the trustee, acting in its capacity as a trustee, of any trust of which he or his immediate family is a beneficiary or, in the case

of a discretionary trust, is a discretionary object; and

- c) any company in which he and his immediate family together (directly or indirectly) have an interest of 25% or more.

5.9 For the purpose of paras 5.1 to 5.8, para 5.7(f)(viii) is capable of successive application⁸.

6 Permissible Investments

6.1 Subject to the restrictions and requirements in paras 7.1 to 7.7, a property trust may only invest in:

- a) Real estate, be it freehold, leasehold and/or as joint owner, and whether in or outside Singapore²;
- b) Real estate-related assets, wherever the issuers/assets/ securities are incorporated/located/issued/traded;
- c) Listed or unlisted debt securities and listed shares of or issued by local or foreign non-property companies;
- d) Government securities (issued on behalf of the Singapore Government or governments of other countries) and securities issued by a supra-national agency or a Singapore statutory board; and
- e) Cash and cash equivalent items.

6.2 A property trust may invest in local and/or foreign assets, subject to the terms of its trust deed. Where an investment in a foreign real estate asset is made, the Manager must ensure that the investment complies with all the applicable laws and requirements in that foreign country, for example, those relating to foreign ownership and good title to that real estate asset.

6.3 When investing in leasehold properties, the Manager should consider the remaining term of the lease, the objectives of the trust, and the lease profile of the trust's existing property portfolio.

6.4 When investing in real estate as a joint owner (in the case of direct ownership) or a shareholder (in the case of an unlisted company), the Manager should take into account whether the trust can divest its investment within a reasonable period of time and, in the case of real estate, at a reasonable price as defined in para 8.5.

6.5 A property trust may invest in local and/or foreign property funds. Where a Singapore property trust's investment in *foreign* funds exceeds 10% (of the Singapore trust's deposited property), it must comply with the requirements in para 3.5 of the Handbook on investing in foreign unit trusts. Where the Singapore property trust invests in other **locally-registered/incorporated** property funds, it will be subject to the investment limit set out in para 7.3(e).

6.6 Financial derivatives may only be used for the purpose of:

- a) hedging existing positions in a property trust's portfolio, where there is a strong correlation to the underlying investments; or
- b) tactical asset allocation or efficient portfolio management, provided that derivatives are not used to gear the overall portfolio of the trust.

7 Restrictions and Requirements on Investments/Activities

7.1 A property trust must not engage or participate in property development activities whether on its own, in a joint venture with others, or by investing in unlisted property development companies. For this purpose, property development activities do not include refurbishment, retrofitting and renovations.

Revised 29 Nov 2000

7.2 A property trust must not invest in vacant land and mortgages (except for mortgage-backed securities). Subject to para 7.1, this prohibition does not prevent a property trust from buying real estate to be built on a vacant land that has been approved for development.

7.3 A property trust must comply with the following restrictions/ requirements:

- a) Subject to para 7.6, at least 35% of the property trust's deposited property must be invested in real estate. A new trust will be given 24 months from the close of the first launch/offer to comply with this requirement;
- b) At least 70% of the property trust's deposited property must be invested, or proposed to be invested, in real estate and real estate-related assets;
- c) Investments in uncompleted¹⁰ **non-residential property** developments in Singapore or uncompleted property developments outside Singapore must not exceed 20% of the property trust's deposited property;
- d) In para 7.3(c), not more than 10% of the property trust's deposited property can be invested in uncompleted property developments by a single developer¹¹; and
- e) For investments in listed or unlisted debt securities and listed shares of or issued by property and non-property companies (local or foreign) and other **locally-registered/incorporated** property funds, not more than 5% of the property trust's deposited property can be invested in any one issuer's securities or any one manager's funds.

Revised 29 Nov 2000

7.4 In para 7.3(e), a company and its subsidiary companies are regarded as one issuer or manager.

7.5 The investment restrictions/requirements in paras 7.3(c), (d) and (e) are applicable at the time the transactions are entered into. A property trust is not required to divest any assets that breach the restrictions/requirements if such breaches were a result of:

- a) the appreciation or depreciation of the value of the property trust's assets;
- b) any redemption of units or distributions made from the property trust; or
- c) in respect of investments in listed shares of or issued by property and non-property companies (local or foreign) - any changes in the total issued nominal amount of securities arising from rights, bonuses or other benefits that are capital in nature.

7.6 Where as a result of divestment or new issue of units by the property trust, a property trust's investments in **real estate** fall below 35% of its deposited property, the property trust must increase the proportion of its real estate investments to 35% within:

- a) 12 months if the real estate investments fall to a level between 20% and 35% of the property trust's deposited property; or
- b) 24 months if the real estate investments fall below 20% of the property trust's deposited property.

7.7 Para 7.6 would not apply if:

- a) in the case of divestment - the property trust offers to return (by way of redemption above the 10% minimum required in para 9.7) or distributes at least 70% of the proceeds of the divestment in cash within 12 months (in the case of para 7.6(a)) and 24 months (in the case of para 7.6(b));
- b) in the case of a new issue of units - the property trust offers to return at least 70% of the subscription moneys received from such new issue within 12 months (in the case of para 7.6(a)) and 24 months (in the case of para 7.6(b)); or
- c) in the case of either divestment or new issue of units - the property trust is in the process of being wound up.

8 Valuation of the Trust's Real Estate Investments

8.1 A full valuation of each of the property trust's real estate assets must be conducted by a valuer *at least* once a year, in accordance with any applicable Code of Practice for asset valuations.

8.2 Where the Manager proposes to issue new units for subscription or redeem existing units, a valuation of all the trust's real estate assets must be conducted by a valuer *unless* the asset(s) has/have been valued not more than 6 months ago (based on the date of the

valuation report). Where the manager of a property trust offers to redeem units more than once a year (in accordance with paras 9.1 to 9.12), only one of these redemption offers must be based on a full valuation; the other redemption offer(s) may be based on desktop¹² valuations.

Revised 29 Nov 2000

8.3 A valuer for the purpose of paras 8.1 to 8.8, be it for a full or desktop valuation, must:

- a) not receive payments of more than \$200,000 aggregated over the current financial year from the Manager, adviser or the other party/parties whom the property trust is contracting with. For the avoidance of doubt, this does not include fees paid by the property trust to the valuer for valuation work undertaken for the trust;
- b) not be a related corporation of or have a relationship with the Manager, adviser or other party/parties whom the property trust is contracting with which, in the opinion of the Trustee, would interfere with the valuer's ability to give an independent and professional valuation of the property;
- c) disclose to the Trustee any pending business transactions, contracts under negotiation, other arrangements with the Manager, adviser or other party/parties whom the property trust is contracting with and other factors that would interfere with the valuer's ability to give an independent and professional valuation of the property, The Trustee shall then take such disclosure into account when deciding whether the person concerned is sufficiently independent to act as the valuer for the property trust;
- d) be authorised under any law of the State or country where the valuation takes place to practise as a valuer;
- e) have the necessary expertise and experience in valuing properties of the type in question and in the relevant area; and
- f) not value the same property for more than 2 consecutive years.

Revised 29 Nov 2000

8.4 For the avoidance of doubt, an adviser appointed by the Manager pursuant to para 3.3(a)(ii) cannot value the properties that it recommends to be bought or sold by the property trust. However, that adviser may value the property after it has been acquired by the trust.

8.5 Subject to para 5.1(d) in respect of interested-party transactions, a property trust must purchase or sell real estate assets at a reasonable price. A "reasonable price" means:

- a) In the case of acquisitions, a price not more than 110% of the value assessed in a valuation report (valuer to be commissioned by the trust) which is not more than 6 months old; or
- b) In the case of disposals, a price not less than 90% of the value assessed in a valuation report (valuer to be commissioned by the trust) which is not more than 6 months old.

8.6 For the purpose of para 8.5, the date of acquisition or disposal means the date of the Sale and Purchase Agreement. Where there is more than one valuation conducted by more than one valuer for the same real estate asset, the Manager shall use the average of the assessed values.

8.7 Where a real estate asset is to be bought or sold at a price other than that specified in para 8.5, *prior approval* must be obtained from the Trustee.

8.8 Notwithstanding paras 8.1 and 8.2, a valuation of the property trust's real estate assets may be conducted if the Trustee or Manager is of the opinion that it is in the best interests of unit-holders to do so.

9 Borrowing Limits and Redemption Requirements

Borrowing Limits

9.1 The total borrowings of a property trust should not exceed 25% of the trust's deposited property at the time the borrowing is incurred. A property trust may mortgage its assets to secure such borrowings.

9.2 Borrowings may be used for investment or redemption purposes. Where the borrowings are used for redemption purposes the borrowings should be repaid within 6 months.

Redemption of Units

9.3 In respect of **listed** property trusts, Managers can, upon application under section 119 of the Companies Act, be considered for exemption from the requirement to redeem units requested by investors. Where the listed property trust is exempted from the requirement to redeem units, the trust's marketing material (including the Seventh Schedule statement) must contain a clear statement to the effect that unit-holders will have no right to request the Manager to redeem their units, and a warning to prospective investors that being listed on the SGX does not guarantee a liquid market for these units.

9.4 Where a **listed** property trust provides for redemption, units must be redeemed in accordance with paras 9.6 and 9.7. Such an offer to redeem units must be made known publicly to investors through the SGX *at least* 14 calendar days before the offer is posted.

9.5 In respect of **unlisted** property trusts, Managers must offer to redeem units *at least* once a year in accordance with paras 9.6 and 9.7.

9.6 Any offer to redeem units pursuant to para 9.4 or 9.5 must be sent to unit-holders with adequate notice, and must state:

- a) the **indicative price** at which each unit will be redeemed;
- b) the period during which the offer will remain open (this period must last for *at least* 21 calendar days, **but** in no case should it remain open for more than 35 calendar days, after the offer is made);
- c) the assets and/or borrowings that will be used to satisfy the minimum amount of redemption requests stipulated in para 9.7 or a greater amount proposed by the Manager, as the case may be. In the case of non-cash assets, the amount of money that is expected to be available from the sale of such assets should be stated;
- d) subject to the minimum amount stipulated in para 9.7, that if the money available (from cash, sale of non-cash assets and/or borrowings earmarked in sub-para (c)), is insufficient to satisfy all redemption requests, the requests are to be satisfied on a pro-rata basis. For this purpose, no redemption requests made pursuant to the offer may be satisfied until after the close of the offer period;
- e) that the actual price at which the units will eventually be redeemed (as determined by reference to the latest valuations available of the property trust's portfolio of assets after deducting appropriate transaction costs) may differ from the indicative price in sub-para (a) due to changes in the values of the property trust's assets during the offer period;
- f) that the unit-holder must elect, at the same time, whether or not he wishes to proceed with the redemption if his entire redemption request cannot be met; and
- g) that redemption requests made pursuant to the offer will be satisfied within 30 calendar days after the closing date of the offer. Such period may be extended to 60 calendar days after the closing date of the offer if the Manager satisfies the Trustee that such extension is in the best interest of the property trust. The 30-day period may be extended beyond 60 calendar days after the closing date of the offer if such extension is approved by unit-holders.

9.7 In respect of any offer to redeem units pursuant to paras 9.4, 9.5 and 9.8, *at least* 10% of the total value of the property trust's deposited property must be offered. Where the total amount of redemption requests received by the Manager are for less than 10%, all redemption requests must be met in full.

9.8 Subject to para 9.10, where a property trust listed on the SGX:

- a) has been suspended from trading for at least 60 consecutive calendar days; or
- b) has been delisted from the SGX;

the Manager shall, within **30 calendar days** from the date of the specified event, offer to redeem units in accordance with paras 9.6 and 9.7.

9.9 In the case of the specified event in para 9.8(a), the Manager must announce such offer publicly not later than the 16th calendar

day after the date of the specified event. For the purpose of para 9.6(b), the offer must remain open for such period (of between 21 and 35 calendar days) as stipulated by the Manager or until such time as the units resume trading on the SGX, whichever is the earlier. This should specifically be disclosed in the offer notice to unit-holders.

9.10 Where trading suspension in the units of a listed property trust is lifted within 30 calendar days after the date of the specified event in para 9.8(a), the Manager need not proceed to make an offer to redeem the units, or if the Manager has announced an offer to redeem before trading suspension is lifted, the offer can be withdrawn. This should specifically be disclosed in the offer notice to unit-holders.

9.11 Where trading suspension in the units of a listed property trust is lifted after the offer period to redeem units has commenced, the Manager must satisfy all such redemption requests as have been received prior to the date the trading suspension is lifted. For the avoidance of doubt, the Manager will not be obliged to satisfy those redemption requests received after the date the trading suspension is lifted. This should specifically be disclosed in the offer notice to unit-holders¹³.

9.12 Where a listed property trust continues to be suspended indefinitely or has been delisted from the SGX, the Manager must offer to redeem units *at least* once a year after the first offer to redeem units as specified in para 9.8 has closed, i.e. the property trust will be treated as an unlisted property trust after such closing date.

10 Disclosure Requirements

10.1 The disclosure requirements set out in these Guidelines are over and above those under the Companies Act and Regulations. In addition, the disclosure provisions in paras 5.1, 5.2, 8.1, 8.2 and 8.3 of the Handbook will apply to a property trust.

Prospectus

10.2 A prospectus must disclose the following:

- a) the investment objective(s) of the property trust, including whether the primary objective is to obtain regular income and/or capital appreciation;
- b) whether and how the property trust will have proper diversification of its investments. Where the property trust proposes to invest in a single real estate asset or where there is a high concentration of its real estate investments, this fact, and the risks arising from the lack of diversification, must be disclosed;
- c) the property trust's policy on divestment of assets, including whether the proceeds are to be returned to investors or to be re-invested;
- d) the particulars of interested-party transactions as specified in para 5.1;
- e) a statement in respect of the real estate assets proposed to be bought by the trust, including the location (country or region) and type(s) of real estate (e.g. residential/ commercial/industrial);
- f) where it is a new property trust - a statement that the Manager has up to 24 months to invest at least 35% of the trust's deposited property in real estate;
- g) where the property trust has identified specific real estate assets to be bought - the period within which the transaction will be completed;
- h) where a new property trust specifies a minimum size of the trust, failing which subscription moneys will be returned to investors - this fact should be disclosed;
- i) details of the property fund's permissible investments, investment restrictions and borrowing limit;
- j) the prohibition on investments by foreign investors where the property trust proposes to invest in real estate subject to the Residential Property Act;
- k) the expertise and experience of the Manager, or its employees, in managing property trusts or in investing in and/or advising on real estate, respectively;
- l) the expertise and experience of the adviser (if any), including a statement detailing the functions of the adviser;

- m) details of all fees and commissions payable to the Manager, adviser and interested parties (if any);
- n) the frequency of valuation of the trust's real estate assets;
- o) the risks of investing in the property trust, including:
 - i) the general risks associated with investing in real estate;
 - ii) the particular risks of its proposed investments;
 - iii) in the case of an unlisted property trust - the risk that an investor is unable to sell his investment readily; and
 - iv) in the case of a listed property trust exempted from the requirement to redeem - a clear statement to the effect that unit-holders will have no right to request the Manager to redeem their units, and a warning to prospective investors that being listed on the SGX does not guarantee a liquid market for these units; and
- p) if applicable, the frequency of and procedure for redemption, realisation charges (if any), and the period within which redemption proceeds will be paid to unit-holders.

10.3 Where specific disclosure provisions in para 10.2 are consistent with or similar to those contained in the Handbook, compliance with para 10.2 will be deemed to satisfy the equivalent provisions in the Handbook.

Continuing Disclosure Requirements

10.4 Para 8.3(a) of the Handbook (in respect of semi-annual performance reports) will not apply to a property trust.

10.5 An annual performance report must be sent to unit-holders within 2 months of the end of each financial year. The report must disclose the following:

- a) details of **all** real estate transaction(s) entered into during the year, including the identity of the buyer(s)/seller(s), purchase/sale price(s), and their valuation(s) (including the method(s) used to value the asset(s));
- b) details of **all** the property trust's real estate assets, including the location of such assets, their purchase prices and latest valuations, rentals received and occupancy rates, and/or the remaining term(s) of the trust's leasehold property(ies) (where applicable);
- c) in respect of the other assets of a property trust - details of the:
 - i) 10 most significant holdings (including the amount and percentage of fund size at market valuation); and
 - ii) distribution of investments in dollar and percentage terms by country, asset class (e.g. equities, mortgage-backed securities, bonds, etc.) and by credit rating of all debt securities (e.g. "AAA", "AA", etc.);
- d) details of the trust's exposure to derivatives, including the amount (i.e. net total aggregate value of contract prices) and percentage of derivatives investment of total fund size and at market valuation;
- e) details of the property trust's investment in other property funds, including the amount and percentage of total fund size invested in;
- f) details of borrowings of the property trust;
- g) the total operating expenses of the trust, including all fees and charges paid to the Manager, adviser and interested parties (if any), and taxation incurred in relation to the trust's real estate assets;
- h) the performance of the trust in a consistent format, covering various periods of time (e.g. 1-year, 3-year, 5-year or 10-year) whereby:

- i) in the case of an unlisted property trust - such performance is calculated on an "offer to bid" basis over the period¹⁴; or
- ii) in the case of a listed property trust - such performance is calculated on the change in the unit price transacted on the stock exchange over the period¹⁵.

Calculation of trust performance should include any dividends/distributions made assuming that they were reinvested into the property trust on the day they were paid out¹⁶;

- i) its NAV per unit at the beginning and end of the financial year; and
- j) where the property trust is listed - the unit price quoted on the exchange at the beginning and end of the financial year, the highest and lowest unit price and the volume traded during the financial year.

11 Interpretation of Guidelines

11.1 In interpreting these Guidelines, regard should be had to the spirit of the Guidelines, and to the economic and commercial substance of any transaction (in respect of the property trust), instead of just legal form and technicality.

11.2 In particular, investments in other property funds under paras 6.5 and 7.3(e) must not be made with a view to circumventing the letter or spirit of the prohibition on interested-party transactions set out in paras 5.1 to 5.9.

Appendix A1

The Requirement to Redeem Units of a *Listed* Property Trust that has been Continuously Suspended from Trading for 60 Calendar Days

Date	
D/MM/YY	The first day when units of a listed property trust are suspended from trading on the SES.
D + 60 days	On the 60th day that units of the listed property trust have been continuously suspended, the requirement in para 9.8(a) is triggered.
D + 76 days	The last day for the Manager to announce publicly that an offer to redeem units will be made in 14 days' time, in compliance with para .8(a).
D + 90 days	The last day for the Manager to make an offer to redeem units, i.e. the offer period must begin by this date, as required by para 9.8(a).
D + 111 days	The offer to redeem units must be open at least until this date (assuming the units continue to be suspended from trading on the SES), i.e. the offer must remain open for at least 21 days, but in no case should it remain open for more than 35 days.
D + 141 days	The last day for the Manager to pay those unit-holders who have requested redemptions during the offer period [assuming the offer period is open for the minimum 21 days stipulated in para 9.6(b)], <i>unless</i> the payment period has been extended with the approval of the Trustee or unit-holders, as the case may be.

The above timeline governs redemptions set out in paras 9.8(a), 9.9 to 9.11 of these Guidelines, i.e. for a listed property trust that has been continuously suspended from trading for 60 calendar days. The following examples illustrate how the timeline works in various scenarios.

Scenario 1:

Where trading suspension in the units of a listed property trust is lifted between the period (D + 60 days) and (D + 76 days):

- the manager need not announce or make an offer to redeem units.

Scenario 2:

Where trading suspension in the units of a listed property trust is lifted between the period (D + 76 days) and (D + 90 days), i.e. after the Manager **has announced** its offer to redeem units:

- the Manager need not proceed to make an offer to redeem units, or if the Manager has announced an offer to redeem before trading suspension is lifted, the offer can be withdrawn.

Scenario 3:

Where trading suspension in the units of a listed property trust is lifted between the period (D + 90 days) and (D + 111 days), i.e. after the **offer period** to redeem units **has commenced**:

- the Manager will be obliged to satisfy all such redemption requests as have been received prior to the date the trading suspension is lifted.

Scenario 4:

Where trading suspension in the units of a listed property trust is lifted after (D + 111 days), i.e. after the **close of the offer period**:

- the Manager will be obliged to satisfy all redemption requests received during the offer period (either in full or pro-rated if the requests received are more than the minimum amount stipulated in para 9.7).

¹ A mortgage-backed security issued by a special purpose vehicle does not come within the ambit of this para.

² For listed property trusts, announcements must be made to the exchange for public release as stated in SGX's listing requirements. For unlisted property trusts, announcements must be made either through paid advertisements in at least one newspaper that is circulated widely in Singapore, or by sending a circular to unit-holders.

³ For this purpose, a company, its subsidiary companies, its associated companies, and all their directors, chief executive officers and substantial shareholders are regarded as one party.

⁴ A related corporation as defined in the Companies Act includes the holding company, subsidiary and fellow subsidiary.

⁵ For the avoidance of doubt, an entity acting merely as a marketing or sales agent will not be considered a sponsor/promoter.

⁶ Where the sponsor/promoter, Manager or adviser is an associated company of more than one company, say, Company X and Company Y, all the subsidiaries of either Company X or Company Y will be considered as interested parties under this sub-para.

⁷ This refers to his wife, child, adopted child, step-child, brother, sister and parent.

⁸ For example, Company A is a subsidiary of the promoter of the fund. If Company B is a subsidiary of Company A, and Company C is a subsidiary of Company B, then Company B and Company C (and so on) will be considered as interested parties under para 5.7(f)(viii).

⁹ In respect of investments in Singapore, a property trust must comply with the provisions of the Residential Property Act.

¹⁰ An uncompleted property is one that has not been granted a Temporary Occupation Permit or equivalent by the relevant authorities.

¹¹ For the purpose of this para, the value of the investment refers to the contracted purchase price and not the value of progress payments made to date.

¹² A desktop valuation is one based on transacted prices/yields of similar real estate assets, without a physical inspection of the property.

¹³ See Appendix A1 for some examples illustrating how the requirements in paras 9.8 to 9.11 work in relation to a listed property trust that has been continuously suspended from trading for 60 calendar days.

¹⁴ For the purpose of comparing the property trust's performance with an index or other property funds, such comparisons must be made based on the requirements set out in para 7 of the Handbook.

¹⁵ This should be based on the closing price on the last day of the preceding reporting period (or in the case of a new fund, the opening price on the first day of trading) compared with the closing price on the last day of the current period.

¹⁶ The price at which dividends/distributions are assumed to be reinvested shall be the bid price (in the case of an **unlisted** property trust) or the closing price of the unit traded on the stock exchange (in the case of a **listed** property trust) on the ex-dividend or ex-distribution date.

LIST OF INTERVIEWEES

Pua, Sek Guan
Managing Director (Retail)
CapitaLand Commercial Ltd

Dr Yu Lai Boon
Director, Asia Pacific
Chief Innovation Strategist, Asia Pacific

Neo, Charles
Associate Director, Research
UBS Warburg Singapore

Neo, Boon Sim
Assistant Director
Industry Development Division
Monetary Authority of Singapore

Tai, Ying Loong
Associate
GIC Real Estate Pte Ltd