Corporate Governance: The Case for Asian REITs

by

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Submitted to the Center for Real Estate in Partial Fulfillment of the Requirements for the Degree of Master of Science in Real Estate Development

at the

Massachusetts Institute of Technology

September, 2009

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ABSTRACT

At the entity level, the design of sound corporate governance mechanisms is critical for REITs that are preparing to go public. At the industry level, issues of transparency and corporate governance are consequential to the further development of REITs in Asia. This study looks at various REIT regimes and corporate governance systems around the world. It then proceeds to examine the governance structures in place at the time of an IPO in the emerging REIT market of Singapore. The mechanisms of corporate governance used to evaluate the IPO of the REIT include (i) board structure and composition, (ii) ownership, (iii) compensation, and (iv) takeover defenses. The findings point to evidence that corporate governance structures are not “one size fits all” and must be tailored to fit the appropriate institutional context.

Thesis Supervisor: Lynn Fisher
Title: Associate Professor of Real Estate
ACKNOWLEDGEMENTS

I would like to express my gratitude and appreciation to my advisor, Lynn Fisher, for her endless energy in helping me prod, shape and poke incessantly into my thesis topic of choice. Her invaluable insight and advice helped my thesis take on its own life over the arduous summer months. It was never an easy task, but she made the process an enjoyable, enriching, and stimulating one.

The many people that I have to thank over the course of my year at MIT include: my classmates – we all made sacrifices to be here, I couldn’t be happier for the wonderful group of friends that have walked this path with me, and our faculty and staff – for their dedication and investment in each and every one of us. Thank you.
This thesis is dedicated

To Ron for being my source of inspiration and drive, for giving me the courage and strength to follow through, I could not have done this without you.

I look forward to our new life together.
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CHAPTER 1 - INTRODUCTION

1.1 Introduction

**US Pioneers REITs**

Real estate investment trusts ("REITs") are companies dedicated to owning and, in most cases, operating income-producing real estate, such as apartments, shopping centers, offices and warehouses. Pioneered in the United States ("US") by an act of Congress, REITs were first introduced in 1960 as a way of allowing smaller investors to invest in large-scale, income-producing real estate through equity ownership in companies. Among several tests to qualify as a REIT, an entity has to have revenue primarily from real estate investments and is required to distribute at least 90 percent of their taxable income to shareholders.\(^1\)

The US REIT industry can be defined by the two periods of growth - the pre-modern and post modern era. In the period leading up to the early nineties, the REIT industry suffered from setbacks of slow growth and lack of investor confidence. A couple developments on the capital markets and legislative side helped to trigger developments in the early nineties. The tax reform act of 1986 eliminated the tax advantage of real estate limited partnerships and in turn, increased the attractiveness for owners of private real estate to go public by contributing their properties in a tax efficient manner through REITs. The Kimco Initial Public Offering ("IPO") in 1991 is widely credited as ushering the beginning of the "modern REIT era". The introduction of the Umbrella REIT ("UPREIT") structure by the Taubman Companies also further facilitated the public acceptance of the publicly-traded REIT vehicles. In addition, the look-through provision of 1993 relaxed the "five or fewer rule" ownership requirement for pension funds and allowed the industry to grow further with more institutional participation. Since then, REITs have provided ongoing dividend income along with the potential for long-term capital gains through share price appreciation, and also served as a powerful tool for portfolio balancing and diversification for investors.

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\(^1\) Please refer to Appendix for REIT qualification criteria.
Maturity Brings Governance

If congressional intent in introducing REITs was arguably to allow the everyday man a chance to have a stake in the wealth of a nation’s real estate, the importance of protecting these shareholders’ interest has been underscored by the corporate governance mechanisms that have been implemented in regulating REITs. The REIT market has matured, in terms of its depth and breadth, its managerial talent, its legislation, and importantly in terms of its governance. There is increasing empirical evidence on the positive relationship between good corporate governance practices and a firm’s market valuation, while consensus in financial circles also shows corporate governance is gaining an important role in investment decisions. The US REIT industry has grown dramatically since inception from a market capitalization of less than USD 10 billion in 1990 to approximately USD 300 billion today.

International REITs have followed

The ongoing success of the REIT model in the US has led many countries in Asia to introduce a REIT-like structure to facilitate capital inflows into their respective real estate sectors as well. Countries such as Singapore, Hong Kong, Taiwan, Thailand, Japan, Malaysia and Indonesia have boarded the current REIT bandwagon with their own REIT IPOs. As one of the fastest growing regions in terms of gross domestic product and urbanization rates, Asia represents a large frontier market for REITs. The proportion of REIT ownership of institutional-grade real estate in many Asian cities has been steadily increasing over the past ten years. Asia also has the lowest level of securitized real estate in the world. In September 2006, UBS estimated that only approximately 4 percent of investment grade real estate in Asia was held in REIT-type structures.\(^2\) The two most populous nations of China and India have yet to introduce legislation for REITs, but there has been much speculation that this could be a reality within a few years.

As we continue to see a structural shift from private to public ownership of real estate in these emerging markets, the importance of studying the mechanisms and effectiveness of corporate governance in these REITs is equally relevant as its growth. Just as REITs have proliferated in

\(^2\) Source: UBS Q Series Research: Can Asian REITs Recycle Capital for Half the World’s Population?
the US markets, they will too in Asia as an ideal vehicle for placing capital in international real estate.

1.2 Research motivation and questions

In writing this paper, my goal is to educate and advocate for the increased role of corporate governance in the Asian REIT markets. In wake of the 1997-1998 Asian crisis, the continuing relevance of corporate governance to the growth of the Asian economies has been underscored. I have been interested in synthesizing the available information on the emergence of REIT vehicles in Asia and applying the current knowledge to the debate of corporate governance issues that these vehicles have brought to surface. Corporate governance structures are essential for a well-developed, functioning marketplace. The presence of a good, effective corporate governance system helps to instill confidence in the market and facilitate a more information-efficient economy. Both of which are the underpinnings of economic growth, whether in Asia or globally.

The cost of good governance does not come cheaply. The benefits of adopting high standards should, however, outweigh the drawbacks as the real estate sector, enabling REITs in particular to move toward greater efficiency, stability, and long-term growth.

1.3 Research methodology and Structure of thesis

Using the US REIT market as a touchstone, this thesis examines the current corporate governance mechanisms in place for Asian REITs. While ex-ante evidence on public-listed firms’ valuation shows the positive relationship between corporate governance and share price, the use of initial public offerings (“IPO”) helps to mitigate any endogeneity issues and offers lessons learned in REIT formation. This thesis is a qualitative study drawing upon an extensive

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3 In econometrics, the problem of endogeneity occurs when parameters in a model are predicted by variables other than those defined by the model. An pricing model for newly-public firms can be isolated around the single IPO event while seasoned firms will have more variables, other than those present at time of IPO that will affect their pricing.
collection of academic research, trade publications and journals, analyst reports, REIT securities rules, and public financial reports for listed REITs. In addition, a case study, CapitaRetail China Trust (“CRCT”), in the emerging REIT market of Singapore is used to illuminate the variation in governance structures in mature versus emerging markets. Having first pioneered REITs in Asia and then going on to introduce cross border vehicles, CRCT’s sponsor, CapitaLand has a history of being an innovative real estate developer. CapitaRetail China Trust is one of CapitaLand’s cross border REITs investing in retail property assets in China, and its successful IPO helps to highlight critical governance mechanisms in Singapore.

In my thesis, I will refer to the US as a “mature” market with regards to the REIT industry, and countries in the infancy of their growth as “emerging” markets. Many of these other countries such as Japan, Hong Kong, Singapore, Thailand, and Malaysia, are just in the early stages of their growth cycle.

In order to achieve the research objective set forth in the previous section, this thesis is organized into five chapters.

Chapter 1 starts by briefly providing the background and context surrounding the research. The research motivation, objectives, and methodology are also introduced.

Chapter 2 introduces important concepts of corporate governance and its history in the Asian context. The chapter also discusses the different mechanisms that are used to govern to REITs. This chapter also proceeds to review the current literature on the topic.

Chapter 3 provides an in-depth overview of various REIT legal regimes around the world and a comparative analysis of the same. It will introduce the role of legislation in catalyzing REIT markets.

Chapter 4 takes a closer look at CRCT’s IPO that had taken place in the emerging REIT market of Singapore. Due to the maturity and size of the United States REIT markets, its legislation and governance structures are used as an important point of reference.
Chapter 5 draws conclusions of the research and addresses the future of corporate governance in emerging REIT markets.
CHAPTER 2 - BACKGROUND AND LITERATURE REVIEW

2.1 Principles of Corporate Governance

While the appropriate model for corporate governance differs from the economy in question, the generally accepted definition as defined by the Organization for Economic Cooperation and Development (“OECD”) is the “procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.”

Corporate governance addresses the problems that arise from separation of control and ownership of a firm. These mechanisms try to reduce or eliminate related agency costs and conflict of interests that arise from having multiple interest groups or stakeholders. Much of the impetus for sound corporate governance has been driven by the needs of the corporate shareholder to exercise their rights of ownership and control the value of their holdings. Sound corporate governance helps to provide a degree of confidence that is essential for the proper functioning of a market economy.

The debate over problems with dispersed versus concentrated ownership and their solutions originated largely in “The Modern Corporation and Private Property” (Berle and Means 1932). Economist Ronald Coase, in "The Nature of the Firm" (1937), introduced the concept of transaction costs to explain the existence, nature and limits of firms. Coase explains why the economy is populated by a number of business firms, instead of consisting exclusively of a multitude of independent, self-employed people who contract with one another.

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4 OECD Principles of Corporate Governance 2004
The seminal work by Jensen and Meckling (1976) provides the primary starting point for the majority of research focusing on internal control and agency costs. Jensen and Meckling identify agency costs as resulting from a separation of ownership and control. However, this separation would not create a conflict if all actions of the manager were known and controllable by the owners. Thus, the discussion of agency costs could also be one of making information accessible to current and potential owners. As such, Jensen and Meckling (1976) argue that agency costs could be reduced by advancements in auditing, formal control systems, and security analyst following.

Jensen and Fama continue to expand the understanding of corporate governance with “The Separation of Ownership and Control” (1983)\(^5\). Fama and Jensen contend that separation of decision and risk bearing functions survives in organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the implied agency problems.

The importance of corporate governance became exceptionally clear when a string of corporate catastrophes in 2002 led to the destruction of billions of dollars of shareholder value. Detailed accounts of corporate fraud, accounting scandals, excessive compensation, and other perceived organizational failures—many of which culminated in lawsuits, resignations, and bankruptcy—were all attributed to a lack of corporate governance. Enron, WorldCom, Aderpia, Tyco, and Global Crossing were all companies that were vetted as “institutional quality” by the public investing community, but yet encountered bankruptcy as their corporate governance mechanism of checks and balances failed. Investor confidence in the stock markets was evidently shaken by what was deemed “unimaginable”. The Sarbanes-Oxley Act was passed quickly by the US Congress and the Securities and Exchange Council (“SEC”) to regulate public companies. The act covers issues such as auditor independence, corporate governance, internal control assessment, and enhanced financial disclosure.

\(^5\) For a discussion of how to control the downside of dispersed shareholder ownership and maximize the benefits from dispersed shareholder ownership and risk bearing, see Eugene Fama & Michael Jensen, Separation of Ownership and Control, 26 L. Law & Econ. 301 (1983).
With the increasing securitization of wealth in various corporate entities and institutions, corporate governance has been the subject of significant debate around the world. According to LRN, a professional provider of ethics and responsibility in the workplace, key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization.

The corporate governance system of a corporation can be divided into two categories, namely internal governance and external governance. The internal governance mechanisms of a firm include monitoring by the board of directors, internal auditors, shareholder-management balance of power, and performance-based remuneration structures. The external governance mechanisms include the capital markets, the public sector, regulations which may be the result of executive/agency decisions and the labor market. Internal corporate governance controls monitor activities and advise corrective action to accomplish organizational goals, while external corporate governance controls encompass the controls external stakeholders exercise over the organization. Together the internal and external governance mechanisms of a firm align the incentives of the managers with shareholders, and motivate managers to maximize firm value.

Global Standards of Corporate Governance
There are many variations on the ideal model of corporate governance around the world. Corporate governance models cannot be seen in isolation to the economies and institutional underpinnings in which they operate (Guillen 2000). The Anglo-Saxon model, also called the liberal model, emphasizes the right of the shareholders and is reflective of its capital-markets driven economy. The Continental European model takes in broader view in that, in addition to emphasizing the rights of the shareholders, it also recognizes the interests of stakeholders such as workers, managers, suppliers, customers, and the community. The OECD report on Corporate Governance in Asia (2004) discusses how corporate governance issues have gained visibility

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6 LRN is a provider of solutions that foster corporate ethics and responsibility in the workplace.
among policy makers due to the increasingly globalization of capital flows as both international and domestic investors demand compatibility and transparency of information. In addition to the globalization of markets, factors such as a more propitious environment for international cooperation and policy debate and a clear convergence of legislative and regulatory trends make it more compelling for the adoption of corporate governance frameworks globally. Guillen, however, argues that while conventional wisdom dictates that models of corporate governance should converge towards a single model due to globalization, evidence shows that there has been little convergence in the two main models in the last twenty years.

In France, where the reception to the American import of corporate governance was initially met with a cold reception, a tremendous breakthrough has been made following spectacular financial losses resulting from unmonitored managerial initiatives (Credit Lyonnais, Michelin, Paribas, Suez, Union des Assurances de Paris) (Naciri 2008). Measures include strengthening of minority shareholders’ rights and internationalization of ownership and corporate boards.

The German corporate governance system is different from that of the Anglo-Saxon countries because it foresees the possibility, and even the necessity, to integrate lenders and employees in the governance of large corporations. The German corporate governance system is generally regarded as the standard example of an insider-controlled and stakeholder-oriented system (Reinhardt 2003). In Germany, shareholders often choose half the members of the board with employees choosing the other half (Fukao 1995).

While Japan has moved towards adopting the Anglo-Saxon model of corporate governance, its biggest obstacle lies in the founding ideologies of the Japanese corporations. Pre-war, Japanese zaibatsu were organized around a bank for their source of capital. This system is usually characterized by long-term cooperative relationships between managers, major shareholders, and business partners. Shares of the corporation are also held by key customers, suppliers and allied corporations on a reciprocal basis (Luo 2007). Culturally, the society is also ascribes to the

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7 Zaibatsu is a Japanese term that refers to the large family owned conglomerates that controlled much of the Japanese economy prior to World War II during the Edo and Meiji periods.
tradition of obligation, family and consensus. Although Japanese policy makers have emphasized the importance of adopting effective corporate governance structures, the post-war *keiretsu*\(^8\) industrial groups (which have taken over the now-illegal *zaibatsu*) are not fundamentally or culturally different from their predecessors in many ways.

The Korean system of centralized shareholding is an outgrowth of its tradition of family ownership with company founders and family members maintaining majority share and control of in the companies. The model of the Korean *chaebols* rely on a complex system of interlocking ownership which impede the establishment of effective corporate governance structures without first being dismantled\(^9\).

The Asian financial crisis of 1997 has played the role of catalyst in the corporate governance debate by highlighting the lack of effective corporate governance control mechanisms. On one hand, there is weak outside monitoring by shareholders in firms, capital markets, and capital institutions. On the other hand, there is concentration of control in small groups of interest that are often very closely connected to the state and the financial sector. The legacy of family-owned and family-controlled businesses, together with cross-holdings among corporations added to the web of problems faced by the Asian economies. The lack of transparency of these arrangements, combined with increasing corporate exposure (direct and indirect) to international capital markets created vulnerabilities that led to the crisis. Johnson, Boone, Breach and Friedman (1999) found that measures of corporate governance, particularly the effectiveness of protection for minority shareholders, explain the extent of depreciation and stock market decline in the Asian financial crisis of 1997 better than do standard macroeconomic measures. They

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\(^8\) *A keiretsu* is a group of closely related Japanese companies, often with interlocking ownership. Traditionally, there have been both horizontal and vertical keiretsu. Horizontal keiretsu center on a main bank and their companies span various industries. Vertical keiretsu center on a major manufacturer, like Toyota, and include its various suppliers and wholesalers. It encourage its members to award contracts to sister companies and cooperate with each other for the overall good of the keiretsu. The keiretsu dominated the Japanese economy in the last half of the twentieth century.

\(^9\) The Korean *chaebols* are the large, conglomerate family-controlled firms of South Korea characterized by strong ties with government agencies.
find that in countries with weak corporate governance, worse economic prospects possibly result in more expropriation by managers and thus an even larger fall in asset prices.

In wake of the crisis, Asian economies have issued new corporate governance codes to promote best practices among their constituents. The international financial institutions (IFIs) which organized the emergency financial assistance for the crisis economies - the International Monetary Fund, World Bank and Asian Development Bank - were instrumental in the inclusion of corporate governance on the reform agenda. Yet prior to the crisis, corporate governance had not been a part of these institutions' crisis response programs, and the institutions had only limited familiarity with the issue (Metzger 2004).

2.2 Going Public and Corporate Governance

Before a private company becomes a public company, it should look like one. Accessing external capital sources introduces the challenges of ensuring that a REIT’s corporate governance structure is efficient so that the stock will be priced accurately by the investor community. The IPO decision is fundamentally interrelated to the design of an efficient governance structure. The choice of public status is one of balancing the two forces of concentrated private ownership and dispersed public ownership. Just the notion of the perceived quality of a REIT’s corporate governance can influence its share price as well as the cost of raising debt and equity capital in the public markets.

Draho (2004) contends that implementing an effective corporate governance structure at IPO is critical for a number of reasons. Since the firm value is a function of the governance structure adopted, the amount of proceeds that can be raised from the offering is directly impacted. The future firm performance depends on the incentive and control mechanisms that are in place for management. In addition, the legal reorganization of an issuer that precedes the IPO is decided by a small select group of shareholders, pre-dispersion of shareholder base. The structure decided at the IPO stage is likely to persist.
Governance structures established in the IPO process typically share at least the following two characteristics. First, investors must be able to monitor management to ensure that value-maximizing course of actions are undertaken. Secondly, investors must have control rights to take remedial actions against management if monitoring reveals inadequacy or inappropriateness (Draho 2004).

The effect of corporate governance mechanisms on after-market performance of IPOs is not clear as there exists multiple sources of “noise” affecting a firm’s valuation during its life as a public company. On the other hand, IPOs represent a good context in which to study governance choices and the corresponding value that investors assign to the firm because they mitigate the problem of endogeneity that established firms present.

### 2.3 Corporate Governance in REITs

RiskMetrics Group (previously known as Institutional Shareholder Services) measures the governance practices of the US real estate industry by a metric called Corporate Governance Quotient (“CGQ”). The CGQ measures up to 63 corporate governance variables, categorized under four areas of focus: (1) board of directors, (2) audit, (3) anti-takeover provisions, (4) executive and director compensation. Some of the variables are reviewed together under the premise that corporate governance is enhanced when selected combinations of these variables are adopted. The findings for real estate companies have been well-above average for the last five years. The real estate industry ranking has the second-highest average Index CGQ among all industries behind utilities. Among the US real estate companies, Developers Diversified Realty

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10 Corporate Governance Quotient (CGQ®), a corporate governance rating system provided by Risk Metrics Group (fka Institutional Shareholder Services) on over 8,000 companies worldwide, evaluates the strengths, deficiencies, and risks of a company’s corporate governance practices and board of directors.

11 CGQ rates the governance practices of 200 real estate companies in the United States, virtually all of which are REITs.
Corp., Regency Centers Corp. and AMB Corp., scored the highest for CGQ. Please refer to the Appendix for the rankings by industry and by firm.  

While there are many studies that relate the role of corporate governance with the long-term performance of a firm, there are a few legal restrictions and structures that make REITs unique with respect to other firms in regards to the nature of their corporate governance mechanisms.

**Payout Requirement**

Firstly, to qualify as a REIT in the US, the firm has to distribute at least 90 percent of its taxable income (excluding net capital gains) as dividends. This payout requirement tends to mitigate particular agency costs as management of the REIT has fewer opportunities for expropriation of cash flow. However, in turn the payout requirement puts pressure on the REITs to meet their dividend policies and restricts their ability to fund growth through the use of retained earnings. The REIT has to balance its expected dividend yield rate and expected share price growth rate. As the market tends to penalize a REIT’s stock price when it fails to meet dividends, REITs often have to look to the equity and debt markets for additional capital (Hartzell, Kallberg, Liu 2008).

**Management Format/Structure**

Secondly, REITs can choose to be externally-advised (advisor REIT) or internally-advised (self-administered REIT). The REIT’s decision of management structure ultimately affects the corporate governance issues it faces. An externally-advised REIT typically hires a separate business entity to supervise the ongoing entity-level operations of the REIT in exchange for an advisory fee. Such advisory services include, for example, making decisions or recommendations to buy or sell a property, declare dividends, raise capital, or hire on-site managers or other employees, in all cases subject to the oversight of the company’s board of directors or trustees. An externally-advised REIT can have employees as well, but it subcontracts with an outside

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12 Among the mechanisms that are evaluated to determine a REIT’s corporate governance include: Board and Key Committee Independence, Board Practices, Takeover Defenses/Shareholder Rights, Compensation and Ownership, and Audit Factors.
entity for supervisory services. An internally-advised REIT provides these services through its own employees. Greater potential for conflicts of interest exists for advisor REITs relative to self-administered REITs (Sagalyn 1996).

The potential for conflict is especially pronounced when the interests of the REIT sponsor (firm that started the REIT) and the REIT advisor differ from that of the REIT’s stockholders. An example of a potential conflict of interest that can arise is in the acquisition and disposal of real estate assets. The REIT advisor can purchase and manage assets for third-party accounts other than the REIT sponsor. Typically, the advisor does not have an obligation to make investment opportunities available to the REIT sponsor on a right of first refusal basis. Competition for the same investment opportunities frequently can arise between the REIT advisor and the REIT sponsor. The REIT advisor may have different incentives to act on its own behalf and on behalf of the REIT (the basic agency problem). Most REIT advisors share managers, boards of directors and their chief executive with the sponsoring company, which leads to even more conflicts of interest. If the incentives of the directors are not handled appropriately, the governance structure can fail. While efforts should be made to make sure that these conflicts are handled in the “best” manner possible, there may be technically, regulatory or informational reasons why the agency problem can’t be completely solved. Regardless of institutional context, there should be as much disclosure as possible to mitigate the conflict.

However, there are proponents of the external management structure that argue that it can provide significant benefits, e.g. the manager can use its scale to provide services at a more economical cost than managing the REIT internally.

The type of compensation arrangement used can create a moral hazard for the managers. The nature of the contractual agreements between the advisor and sponsor can also lead to non-arm’s-length transactions, or self-dealing, taking place. The REIT may purchase properties from the sponsor (where the REIT is effectively the takeout vehicle for the sponsor’s portfolio) even though there are better options for the REIT. The REIT sponsor may also extend loans to the advisor REIT (or vice versa) at concessionary terms. The share prices of the REITs and that of the sponsor’s (if public), while closely-tied, can be hard to analyze individually.
Please refer to the Appendix VI for more detailed information on the conflicts that exist for externally-managed REITs. Before 1991, REITs in the US were required to hire external managers to manage their assets, effectively prohibiting them from being internally managed, and all REITs at the time of their IPO were externally advised. Most REITs elected self-advised management at the time of their IPO subsequent to the IRS rule change in 1986.

The conflicts of interest inherent in an external management model are potentially mitigated by the sponsor’s substantial equity stake in the REIT. In the largest markets in Asia, most Japanese REITs (“JREIT”s) and Singapore REITs (“SREIT”s) are 30 percent owned by the sponsoring REIT so as to align themselves with the shareholders’ interests.

Depending on the market in Asia, there exist both internally and externally managed REITs. REITs in Korea, Hong Kong and Taiwan are permitted to be managed in either format. REITs in other Asian countries are all externally managed. Australian REITs have a unique stapled structure where the management company is “stapled” on to the REIT, hence internalizing management\(^\text{13}\). An overview of typical management structures of each country are provided in Appendix VII.

Figure 1 below shows a typical externally managed REIT structure in Asia. The REIT is set up as a vehicle to purchase the real estate assets and in return gains net property income flows from the income-producing assets. The external manager provides management services to the REIT in return for management fees. An independent trustee is appointed to act on behalf of the REIT. In return for trustee fees, the trustee’s assumes the role of ensuring that the management team’s activities are consistent with REIT codes and legislation. The unit holders of the REIT purchase units on the public market and receive dividends accorded to them.

\(^\text{13}\) Neo (2007) finds that the Australian REIT markets have seen a full cycle. It started with the listing of private property funds in the early 1990s into externally managed and listed REIT vehicles. Property institutionalization grew rapidly until the late 1990s, subsequently leading to mergers and takeovers. During this period, the internally managed/stapled structure was widely considered to provide better growth prospects through lower management fees and higher growth from development. This was followed by an increase in the number of external REITs being stapled into the manager-listed company.
Ownership Requirement

Third, the Internal Revenue Code ("IRC") restricts the ownership concentration of REITs by requiring that five or fewer individuals cannot directly or indirectly own more than 50 percent of the REIT's shares. This rule effectively limits share ownership of to an average of 10 percent of outstanding shares per unrelated individual shareholder. However, institutional holdings are not regarded as a single investor due to a look-through provision made for large investors such as pension funds and trusts\(^\text{14}\). Due partly to this restriction, REIT insiders and advisors typically own only a minimal amount, if any, REIT shares. The five or fewer rule was originally designed to diffuse ownership and to prevent management from expropriating wealth from small shareholders.

As mentioned previously, in external management structures, the conflicts of interests inherent can be partially mitigated by the sponsor holding a substantial amount of equity in the REIT.

\(^{14}\) Under the look through provisions, certain institutional shareholders will be considered based on the proportional interests of their individual respective shareholders, partners, or beneficiaries. This treatment is called the look through rule, since these entities are looked through to determine if the five or fewer rule is satisfied.
Partnership Structure and Investor Class

Lastly, the umbrella partnership REIT (“UPREIT”) is a variant on the traditional REIT structure. The UPREIT structure has a tax benefit over traditional REITs in the acquisition of properties. An UPREIT holds all of its assets in, and conducts its business through, a subsidiary umbrella partnership in which the REIT is the sole general partner. Owners of real estate transfer their ownership interests to the operating partnership in exchange for limited partner interests in the partnership. Tax deferral is allowed until the partnership units are converted to REIT shares or cash. Typically, the units are converted on a one for one basis for shares. Acquisitions by the operating partnership generally can also be made on a tax deferred basis using operating partnership units as acquisition currency.

Please refer to the following diagram for a typical structure of a UPREIT.

Figure 2: Typical UPREIT Structure

![Diagram of Typical UPREIT Structure]

Source: Arter & Hadden LLP

However, a disadvantage of the UPREIT is that it has the potential for greater conflicts of interest because the UPREIT structure creates two distinct groups of owners: holders of partnership shares and the REIT shareholders. The interests of these two shareholder groups can differ, for example when new shareholders wish to sell properties acquired vis-à-vis partnership
shares. A sale triggers capital gains taxes for shareholders of these partnership shares. Holders of operating partnership units can convert their units into common shares, although this conversion triggers a taxable event (Hartzell, Kallberg, Liu 2008).

### 2.4 Literature Review: Governance and Value

Hartzell, Kallberg and Liu (2008) find that REIT governance structure at the time of the IPO, and their pre-IPO history are important determinants of initial value and future operating performance. Their evidence points to the fact that firms with stronger governance structures have higher IPO valuations and better long-term operating performance than their peers.

In empirical literature, there are a growing number of studies which investigate the effect of one or more alternative corporate governance mechanisms on the performance of firms. The literature has focused on the relation between individual corporate governance monitoring mechanisms and performance. The most recent literature review was conducted by Bauer, Eichholtz, et Kok (2009). Their comprehensive review has found that monitoring mechanisms that have been the subject of performance-related real estate research include board structure (Friday and Sirmans 1998; Friday, Sirmans and Conover 1999; Ghosh and Sirmans 2003), management structure (Ambrose and Linneman 2001; Cannon and Vogt 1995; Howe and Shilling 1990; Wei, Hsieh and Sirmans 1995), inside ownership (Capozza and Seguin 2003; Han 2006), and the involvement of institutional investors (Chan, Leung and Wang 1998; Ling and Ryngaert 1997). These monitoring mechanisms were all found to either individually or collectively influence value.

Campbell, Ghosh and Sirmans (2005) study the utility of the UPREIT structure and find partnership units issued by UPREITs in payment for properties can function as instruments of corporate control, aligning the interests of new executives acquired in the transaction with those of the purchasing REIT’s shareholders. In this process, they have found that significant shareholder value is created. They also find evidence that these financial arrangements are used to signal information regarding the firm’s future prospects.
2.5  Mechanisms

In analyzing the corporate governance structures of REIT IPOs, I will use the following framework. The mechanisms of corporate governance in the IPO of a REIT broadly include:

i. Board Structure and Composition

ii. Ownership

iii. Compensation

iv. Takeover Defenses

i. Board Structure and Composition

In different governance systems, board systems differ with respects to structure, composition, organization, committees and tasks. A one-tier board system comprises both executive and non-executive directors. In this system, executives perform double functions of both day-to-day, operations and management roles and board oversight roles. A two-tier system separates the executive and non-executive directors. The highest level consists of only non-executive directors that provide supervision, control and strategic advice, while the second level consists of executive directors responsible for execution of strategic decisions. Stakeholder models of corporate governance tend to favor the two-tier system of board structure, but the actual structure adopted by different countries and firms tend to position themselves along these two continuums.

In both shareholder models and stakeholder models, an emphasis is placed on the percentage of independent, non-executive directors on boards to provide an appropriate check and balance on the CEO and management. Fully independent nominating, compensation and audit committees provide additional checks on the management’s decisional powers.

ii. Ownership

Ownership structure refers to the various patterns of control and cash flow rights which shareholders possess. The idea behind the concept of ownership structure is to be able to understand the way in which shareholders interact with the firm and each other. An ownership structure assigns rights to individuals or groups of individuals, as well as, prescribes the mechanisms for the acquisition, disposal and transfer of these rights. Rights may be defined with
respect to control and/or cash flow (described in more detail in the following section “Compensation”). Control rights measure the degree of control given by a share or control chain, while cash flow rights measure the cash flow entitlement produced through ownership of the share.

In general, two major dimensions of ownership structure are ownership concentration and owner type. Ownership concentration is a quantitative measure which can be reflected by an index; while owner type is a qualitative measure that renders information on the nature of the shareholder. Different owner types bring with them different incentives, utility functions and means of control. These may include management insiders, subgroups of officers and directors, institutional investors, families, company founders, strategic investors and governmental organizations (Grob 2007).

iii. Compensation
Compensation, like ownership-related practices, help define incentives and whether the interests of shareholders and managers are aligned and whether the board is an effective check on management. Compensation arrangements to management and board of directors, while an important driver of incentives, can give rise to potential sources of conflicts. The theory of agency costs highlights the need to align managerial incentives with shareholders goals (Jensen and Meckling 1976). Various performance-based pay structures, in the form of cash or noncash payments such as shares and options, have been used by firms to this end. Stock compensation arrangements with the top REIT executives are normally determined by a committee of independent board directors and are often ratified by the shareholders. Regardless of the type of compensation plan decided upon, of highest relevance is the disclosure and transparency requirement.

\[15\] NAREIT Consultation Paper 2005
iv. **Takeover Defenses**

On one hand, institutional shareholders and corporate governance rating companies have criticized takeover defense plans as a means to entrench management; on the other hand, the presence of takeover defenses has been argued to protect a firm’s true value from hostile acquirers. Most commonly used is a shareholder rights plan which serves to force an acquirer to negotiate with the target company’s board of directors. Typically, if any person or group acquires a certain percentage (usually between 10-25 percent) of the voting power of the company’s outstanding common stock, stockholders of the company (other than the acquiring person) have the right to buy common stock at a substantial discount (often at 50 percent of the market price). This results in substantial dilution of the acquiring person’s investment in the company and would likely thwart the takeover bid.\(^\text{16}\)

Morck, Shleifer and Vishny (1988) found that firm valuation first increases as a result of convergence of interests between managers and shareholders, then declines because of entrenchment of the management team, and finally increases slightly as ownership by the board of directors increases. Field and Karpoff (2002) find that IPO managers tend to deploy defenses

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\(^{16}\) Other anti-takeover protections include:
- Classified boards with staggered terms.
- Limitations on the ability to call special meetings or take action by written consent.
- Supermajority vote requirements to approve mergers.
- Supermajority vote requirements to remove directors.
- The target adds to its charter a provision which gives the current shareholders the right to sell their shares to the acquirer at an increased price (usually 100% above recent average share price), if the acquirer's share of the company reaches a critical limit (usually one third). This kind of poison pill cannot stop a determined acquirer, but ensures a high price for the company.
- The target takes on large debts in an effort to make the debt load too high to be attractive—the acquirer would eventually have to pay the debts.
- The company buys a number of smaller companies using a stock swap, diluting the value of the target’s stock.
- The target grants its employees stock options that immediately vest if the company is taken over. This is intended to give employees an incentive to continue working for the target company at least until a merger is completed instead of looking for a new job as soon as takeover discussions begin. However, with the release of the "golden handcuffs", many discontented employees may quit immediately after they've cashed in their stock options. This poison pill may create an exodus of talented employees. In many high-tech businesses, attrition of talented human resources often means an empty shell is left behind for the new owner.
- The practice of having staggered elections for the board of directors.
when their compensation is high, shareholdings are small, and oversight from non-managerial shareholders is weak. Control issues are important even at the IPO stage of a firm. The legacy structure of anti-takeover provisions that are implemented during the IPO process tends to stay with a firm.
CHAPTER 3 - COMPARATIVE ANALYSIS OF MAJOR REIT REGIMES AROUND THE WORLD

3.1 Major REIT Regimes Around the World

Pioneered in the US in the 1960s, REIT and REIT-like vehicles have been exported globally to more than 30 countries around the world. The total market capitalization of REITs globally was more than US$600 billion\(^7\). The largest REIT market in the world is still the US, but with other regions experiencing massive growth, the gap is narrowing. The past two years has seen a wave of US REIT mergers and acquisitions, hence the fall in number of REITs. Asia and Europe has seen an overall increase in REIT formations and number of REITs. Figure 3 below highlights the growth of REIT numbers by region for selected countries between 2006 and 2008.

**Figure 3: Total REITs by Region, 2006 - 2008**

<table>
<thead>
<tr>
<th>Global Region</th>
<th>Country</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>United States</td>
<td>253</td>
<td>169</td>
<td>148</td>
</tr>
<tr>
<td></td>
<td>Canada</td>
<td>33</td>
<td>26</td>
<td>33</td>
</tr>
<tr>
<td>EMEIA</td>
<td>Netherlands</td>
<td>9</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Belgium</td>
<td>13</td>
<td>17</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>-</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td>30</td>
<td>42</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>Turkey</td>
<td>-</td>
<td>15</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>-</td>
<td>14</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>South Africa</td>
<td>7</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Pacific</td>
<td>Australia</td>
<td>58</td>
<td>58</td>
<td>64</td>
</tr>
<tr>
<td></td>
<td>New Zealand</td>
<td>6</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Asia</td>
<td>Japan</td>
<td>38</td>
<td>41</td>
<td>42</td>
</tr>
<tr>
<td></td>
<td>Hong Kong</td>
<td>4</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>South Korea</td>
<td>11</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Malaysia</td>
<td>11</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>11</td>
<td>16</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td>484</td>
<td>448</td>
<td>451</td>
</tr>
</tbody>
</table>

Source: E&Y EMEIA is a global region made up of Europe, Middle East, India, and Africa. Indian REITs were not analyzed in this report.

The extent of regulation to which REITs are subject varies widely from system to system. Among the 31 REIT regimes around the world in 2008, 18 countries adopted the corporate form, 12 countries adopted the unit trust form and 4 countries adopted the form of a fund.

Trust REITs are governed by general statute and are dealt with in the declaration of trust of bylaws. In general, trust structures offer greater flexibility than both the fund and corporate forms. Corporations have well-defined statute that may not be altered in most cases. These statutes may include standard of conduct for directors, standards for dividends, stockholder approval for charter amendments, procedures for voluntary dissolution and appraisal rights. Many countries like those in Central and South America have REITs that are subject to mutual fund-like rules in which the fund is allow to own real estate.

REITs in Australia and New Zealand are pass-through entities regulated as trusts for corporate law purposes, but their stock exchanges have special rules regulating REITs. This is in contrast with almost all other countries with special REIT provisions in their tax laws for corporations that elect REIT status. As an example, in the US, any entity (including a corporation and business trust) can elect REIT status so long as for US tax purposes the entity is classified as an association taxable as a corporation.

The following table in Figure 4 outlines the various legal forms that countries have adopted. The US REITs are governed by a corporate structure, as are most European REITs. In Asia, the unit trust structure is most predominant. A summary of the legal and regulatory regimes of REITs in Asia are attached in the Appendix.
Global comparative analysis shows that REIT structure and guidelines vary by country. Each country has chosen to implement its own legislative requirements with respect to organizational rules, income rules, asset rules, distribution rules, gearing (leveraging) restrictions and other considerations. Even within the same country, policies have seen to be amended from time to time in accordance with prevailing market conditions. For example, the changing tax policy has been the great driving force behind movements in the US REIT market during its history of almost 50 years.
The comparative analyses of major REIT regimes around the world highlight variances unique to each country’s regulatory and legislative context. However, it is important to conclude from the analyses that beyond variances, some features remain largely similar among the regimes, including:

i. A minimum requirement on the distribution of taxable income (normally at least 90 percent).
ii. Income and asset rules that provide restrictions on investment and development activity of the REIT.
iii. Specifications on taxation exemption at either the REIT or the shareholder level.
iv. The majority of the countries have limitation on a REIT’s leverage ratio.
v. REIT shares are transferable securities on major stock exchanges.

These common features, in sum, characterize REITs as a passive investment vehicle that is liquid, tax-efficient and transparent, and that helps to bring efficiency and diversification to the real estate industry. These common features are applicable to and are key to the success of both established and emerging REIT regimes (Luo 2008).

3.2 Review of Major Asian Markets for REITs

Supported by buoyant economic growth, improving real estate fundamentals and investors’ positive market sentiments, Asia’s REITs have flourished and gained substantial success since its introduction to the region. The market has been growing at an impressive rate, from a mere US$2 billion in 2001 to a whopping US$68 billion in market capitalization as of June 30, 2008. There are currently 115 REITs in Asia with more in the pipeline. REITs have emerged as an increasingly significant investment class in Asia.\(^\text{18}\)

The first REIT to be launched in Asia was the Nippon Building Fund in Japan in September 2001. There are now 41 Japanese REITs (or J-REITs) listed with a total market capitalization in

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\(^{18}\) EY Global REIT Report 2008. Please refer to Appendix for more figures on REIT market capitalization.
excess of US$21.9 billion\textsuperscript{19}. REIT legislation was implemented in other parts of Asia shortly after its debut in Japan with Singapore being the next REIT market to take off. Singapore’s CapitaLand listed its REIT vehicle for retail assets, CapitaMall Trust on the Singapore Stock Exchange in July 2002. Ascendas, one of the largest industrial landlords in Singapore, followed in November 2002 with the Ascendas REIT. Li Ka-Shing, Hong Kong real estate billionaire, took advantage of the opportunity to access cross-border liquidity with the listing of Fortune REIT, a Hong Kong suburban retail asset play on the Singapore Stock Exchange in August 2003. A series of several other REITs owned by Singapore Government-Linked Corporations (“GLCs”) took suit. Hong Kong’s Link REIT was the largest IPO in REIT history with its US$2.8 billion listing in November 2005. Within a matter of weeks of Link REIT’s debut, GZI REIT (mainland Chinese holdings) and Prosperity REIT (another vehicle by Li Ka-Shing holding office and industrial assets) were launched. Korea, Thailand, Malaysia, Taiwan and other Asian countries followed in the same tracks (Whiting 2007).

Ooi, Newell and Sing (2006) have conducted a comprehensive review on the growth of the REIT market in Asia. Ooi, Newell and Sing start by examining the background of macroeconomic, financial market and real estate market development in Asia. In their review, the driving forces for REIT development on the supply and demand sides, government initiatives and market obstacles are also discussed.

A graphical depiction of their tremendous growth within a short time frame can be seen from the Figures 5 and 6. Figure 5 shows the number of REITs in Asia and Figure 6 shows the market capitalization in each country.

\textsuperscript{19} Association for Real Estate Securitization (“ARES”). Data as of 30 April 2009.
According to CapitaLand, one of the leading REIT sponsors in the region, there are a number of factors contributing to the success of Asian REITs, among which, the critical ones are: “quality
underlying assets, attractive yield, professional asset management service, and favorable regulatory frameworks.\textsuperscript{20}

3.3 Asian REITs Attributes

Brief overviews of the general REIT characteristics that are most relevant to the analyses in this paper have been provided in previous sections and the appendix. This section focuses on a few characteristics unique to Asian REITs.

a. External Management
In various REIT regimes in Asia, management of the REIT is largely external even though both forms of management structure are permitted. Hong Kong REITs are split between internal and external management structures, while both Japanese and Singapore REITs are mostly externally managed. There has yet to be a standardization of management in the different countries. The agency costs of external management discussed earlier can be threats to investors’ perception of a REIT’s value.

b. Absence of UPREIT structure
In the US, the UPREIT structure has been used frequently as a tool for tax deferral. In addition, it has been found by Campbell, Ghosh and Sirmans (2005) that REIT managers are able to exploit the unique features of the UPREIT structure in the U.S. to reduce agency costs, signal value, and enhance shareholder wealth. The convertible securities issued by UPREITs in payment for properties acquired from private sellers often function as additional instruments of corporate control. Management’s ownership of these securities helps to align their interests with those of the shareholders. The financial arrangement has also been a positive signal of the REIT’s future prospects.

Findings of Campbell, Ghosh and Sirmans suggest that “the UPREIT structure popular in the US has a usefulness that goes beyond that of being an accommodation to local tax policy.” They

further conclude that “architects of new REITs in Asia and elsewhere should consider the potential value of organizational forms that provide broad flexibility of financing structure in property acquisitions, even if these structures do not provide local tax benefits similar to those that the UPREIT structure provides to shareholders of US REITs.”

c. Sponsors’ Substantial Control

In countries such as Japan and Singapore where external management is most common, agency costs between the REIT and manager are mitigated with ownership structures that intersect at the sponsor level. The manager tends to be wholly-owned by the sponsor, which in turn owns a substantial portion of a REIT’s outstanding stock. In absence of the UPREIT structure such as the US, the sponsor’s ownership in the REIT provides a positive signal regarding the REIT’s future prospects in similar ways with management’s ownership in the UPREIT structure. However, the introduction of this structure also introduces new governance issues. This will be discussed in the case study in Section 4.

3.4 Role of legislation in driving REIT markets

The US Trajectory

Since the US Congress introduced REIT legislation in 1960, the growth in market capitalization and efficiency of REITs has brought with it much advancement in the legislation. Each major growth spurt of the REIT markets was accompanied by legislation.

Summary of Legislative Milestones

1960 – Congress introduces REIT legislation
1986 – REIT Modernization Act
1993 – Relaxation of Five or Fewer Rule
1999 – Taxable REIT Subsidiaries allowed

REITs grew slowly in the 1970s and 1980s as they their benefits to investors was largely eclipsed by Limited Partnerships. In 1986, the REIT modernization act permitted REITs to be self-managed and removed the need to hire an external manager. This allowed REITs to be
much more “active”, integrated corporations. The key to success in 1990s was growth as the ushering in of “mega REITs” occurred. The demand side equation was helped in 1993 when the Five or Fewer Rule for pension fund investment in REITs was relaxed, and hence permitting REITs to “look through” a pension fund to count it as a number of investors equal to its members. The relaxation of this rule helped to channel ever more institutional funds into REIT vehicles. Many REITs, previous to the legislation, relied on asset-by-asset acquisitions. However the decade of the nineties saw many REITs started to grow faster by merging and acquiring other REITs and whole portfolios rather than piecemeal assets. This consolidation brought about large economies of scale in management of the REITs.

The following chart diagrams the path of growth in the number of US REITs and market capitalization of US REITs since the 1970s in response to legislation.
Figure 7: The 1990s REIT Boom and Modern REIT Era

Source: Geltner et Miller
In 1999, legislative was signed in by Bill Clinton that allowed REITs to engage in non-REIT type activity via Taxable REIT Subsidiaries (“TRS”), in which the subsidiary is subject to corporate income tax.

The introduction of TRS has helped to broaden the horizon of REITs and the activities that they are permitted to engage in. TRS have since been used by REIT sponsors for third-party management, for development, for specialty financing activities, for managing foreign currency gains, as well as for providing other non-customary services\(^{21}\). Under the TRS regime, the aforementioned activities caused the REIT to incur a dealer tax penalty\(^{22}\). Also the value of a REIT’s TRS cannot exceed more than 20 percent of the gross asset value of the REIT, making sure that the REIT’s principal focus is on core real estate operations (Bergsman 2005).

Gilbert Menna, chairman of the real estate capital markets practice for Goodwin Procter LLP, says about the 1999 legislative act, “It is one of the major milestones in the modernization of the REIT vehicle since the adoption of REIT legislation in 1960." Richard Jeanneret, area industry leader for Ernst & Young's Mid-Atlantic real estate practice says, "In general, TRS legislation has turned out to be a good thing, because lots of REITs have elected to use them to conduct businesses that are related to their core operations but were not originally intended under the initial REIT legislation. The original REIT legislation was very narrowly focused, but as the real estate economy has evolved the law was changed to keep REITs competitive in the real estate marketplace."

On the other hand, issues have surfaced with regards to the arms’ length nature of the transactions that are conducted between TRS and the parent REIT. REITs are subject to the transfer pricing rules of IRS section 482 that are designed “to allocate the appropriate income and expenses between related corporations and to assess interest and penalties against the

\(^{21}\) Refer to Appendix for a sample of US TRS and their activities.

\(^{22}\) Dealer status under income test for REITs. Refer to Appendix for REIT qualification criteria for details on the income test.
corporations for not using arms' length pricing. Under this transfer pricing code, the REIT can be susceptible to an excise tax if any transaction between itself and the TRS is not conducted at arm's length. Company stock analysts have noted that important disclosure of information on TRS and any subsidiary is important to analyzing the company as a whole. Disclosure of risk and management of the TRS is not always available, a phenomenon that can make investors nervous due to the lack of earnings transparency.

**Figure 8: Recent US Legislative Changes**

- Changing the measurement of the 10% of sales permitted under the safe harbor test from current tax basis to either tax basis or fair market value (at the REIT’s annual option);
- Increasing the size ceiling for taxable REIT subsidiaries from 20% to 25% of assets;
- Permitting healthcare REITs to use taxable subsidiaries in the same manner as hotel REITs;
- Excluding most real estate-related foreign currency gains from the computation of the REIT income tests;
- Providing the US Treasury Department with clear authority to rule on whether a variety of items are ‘good’ REIT income;
- The US REIT industry also benefited from terrorism insurance legislation signed into law by President George W Bush in late-December 2007. The bill included a seven-year extension of the federal government’s terrorism risk insurance backstop, and expanded the scope of the law to include both foreign and domestic acts of terrorism. The new insurance rules help encourage investment in development projects, stimulating economic growth.

*Source: EPRA REIT Report 2008*

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Today US REIT legislation has evolved a long way, and markets across the globe have developed and advanced in their own legislation. “Quite simply, the rise and evolution of REITs has created a “flat” world when it comes to investing in securitized real estate.” According to Eric Corcoran, Managing Editor of the publication, Real Estate Portfolio, who likens the progression of REITs to Thomas Friedman’s theory in the best-selling book “The World is Flat.”

The market capitalizations of the most mature REIT markets in the Asian region arguably reflect the solid regulatory framework provided by their governments to encourage and foster the growth of their local REIT markets. Using Australian Macquarie Bank’s Evolution and Cycle of Listed Property and Securities (“ECLIPSE”) model, Whiting (2007) lays out a road map to understand the probable evolution of Asian REIT markets. The ECLIPSE model covers the Asia Pacific region which includes the countries in the Asia region plus Australia and New Zealand. The ECLIPSE model shows that evolution of the REIT markets are driven by different factors at different stages of their growth cycle. The catalyst for the emerging growth in Stage 1 and 2 is broadly seen to be a combination of attempts by owners to gain liquidity from their assets and governments’ legislative action. One of the largest constraints for the REITs to take off is their high cost of capital in Stage 1. The legislative support from governments in these Stages can provoke strong share price gains by REITs to move them into the next Stage.

For purposes of this thesis, I will study the legislative efforts of the Singapore REIT markets which have progressed considerably from Stage 1 and 2, into Stage 3. In Stage 3, REITs go through a period of acquisition-driven growth where the market prices the REIT’s stock for growth. In turn, with a cost of capital low enough to acquire buildings that are yield-accretive, REITs can gain first mover advantage to consolidate their platform of assets. This stage ends when yield accretive acquisitions are difficult to find and REITs start looking to buy abroad.

The ECLIPSE model is shown in the following diagram and more detail can be found in Appendix VII.
The regulatory and operating environment of the Singapore REIT (“SREIT”) has undergone substantial liberalization over the years. In 1998, the Monetary Authority Singapore (“MAS”), the de-facto central bank of Singapore, released its guidelines on the regulations of real estate funds and trusts. Though legislation was enacted in 1998, SREITs did not take off immediately due to weak economic conditions precipitated by the Asian currency crisis. In October 2001, CapitaLand’s first attempt at the IPO of SingMall Property Trust was aborted due to under subscription of their US$300 million issue. The preceding September 11 attacks on the World Trade Center did not help investor sentiment either. It was only in July 2002, that CapitaMall successfully held the IPO of the first Singapore REIT.

On the supply side, the role of Singapore government-linked corporations (“GLC”s) in catalyzing the growth of the REIT market has been pivotal. GLCs such as CapitaLand, Ascendas, and Mapletree were pioneers in the SREIT market with their successful IPOs. On the
demand side, the government provided a big push via the liberalization of the Central Provident Funds (“CPF”) Savings Scheme. The CPF is a mandatory social security savings scheme governed by the CPF Board. This helped to channel the retirement savings of Singaporeans into SREITs. The Singapore government also helped to increase foreign investor demand of SREITs by extending full tax exemptions to foreign investors as well\textsuperscript{24}. Once it seemed apparent to the government that REITs were not taking on excessive risk on behalf of investors, gearing limits for REITs were also lifted from initial 25 percent to 35 percent to allow for more aggressive growth. Furthermore, REITs that were able to obtain a credit rating were allowed a gearing limit of 60 percent. The government’s decision to adopt the more flexible gearing ratio possible allowed the market to determine whether the REIT managers have adopted the best business model.

In the US, REIT leverage rose to the 70-80 percent range in the late 1980s and early 1990s. After the real estate downturn of 1989-91, caused in part by the US savings and loan crisis, the market in the mid-1990s provided equity in initial public offerings only to those companies that used very conservative leverage ratios in the low 30 percent range. Since then, US REITs have produced consistent operating results and both the equity markets and the credit rating agencies have become comfortable with leverage ratios in the 45-50 percent range. NAREIT’s opinion is that restricting the leverage ratios to a fixed percentage could severely limit a manager’s ability to cope with changed economic conditions\textsuperscript{25}.

In its most recent reactive change to market conditions, it was announced in June 2007 that the Singapore Takeovers and Mergers Code would be extended to include SREITs. This has the effect of allowing the REIT industry to consolidate and perhaps allow greater economies of scale. Drawing much from the US REIT legislation, the 2007 MAS REIT guidelines brought several changes to the original Singapore REIT rules. The new framework introduced the income test, enhanced disclosure on short-term yield enhancing arrangements, discouraged arrangements that entrench a manager's position, disallowed discounts to institutional investors at IPO and

\textsuperscript{24} Information on the Singapore CPF is available at www.cpf.gov.sg.
\textsuperscript{25} NAREIT Consultative paper
increased the minimum threshold for investment in real estate (MAS 2007). These changes have all had positive effects in strengthening the governance mechanisms for SREITs.

MAS’s continued revision of the SREIT regulations has created a robust regulatory regime that has been reactive to the needs of the SREIT market. The following timeline summarizes the legislative revisions that the government has undertaken. Ho (2007) remarks that it “reflects sustained commitment by the MAS to hone Singapore as the preferred choice for a REIT listing in Asia.”

Figure 10: Timeline of SREIT Legislation

<table>
<thead>
<tr>
<th>Year</th>
<th>Legislative Revision</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>Revised SREIT guidelines and approved tax transparency (dividends taxed at individual shareholder’s personal tax rate)</td>
</tr>
<tr>
<td>2002</td>
<td>Usage of Central Provident Funds is allowed for investment in REITs</td>
</tr>
<tr>
<td>2003</td>
<td>Gearing limit of SREIT is increased from 25 to 35 percent</td>
</tr>
<tr>
<td>2004</td>
<td>Full tax exemption for local and foreign investors</td>
</tr>
<tr>
<td>2005</td>
<td>Withholding tax paid by foreigners reduced from 20 percent to 10 percent for five years (effective February 2005)</td>
</tr>
<tr>
<td></td>
<td>Waiver of stamp duty of 3 percent for five years</td>
</tr>
<tr>
<td></td>
<td>Gearing limit of SREIT is further increased from 35 to 60 percent (contingent on rating from credit rating agency)</td>
</tr>
<tr>
<td>2007</td>
<td>Licensing regime introduced for REITs managers under the Securities and Futures Act (“SFA”)</td>
</tr>
<tr>
<td></td>
<td>Enhanced disclosure requirements</td>
</tr>
<tr>
<td></td>
<td>Removing the 5% single party limit for investments in real-estate related securities</td>
</tr>
<tr>
<td></td>
<td>Requiring a REIT to invest at least 75% of its assets in income-producing real estate</td>
</tr>
<tr>
<td></td>
<td>Extension of Takeover code to REITs to allow easier mergers and acquisitions</td>
</tr>
</tbody>
</table>

Source: Monetary Authority of Singapore and Author’s rewrite

George Noon, an international director at LaSalle Investment Management in Baltimore, says “REITs around the globe will grow more akin to the US model as their markets mature and investors grow comfortable with that structure.” For example, the US once required that a REIT be externally managed. That is currently a requirement in parts of Asia, but “will likely be eased over time.”
CHAPTER 4 - CASE STUDY OF AN ASIAN REIT IPO

4.1 CapitaRetail China Trust

CapitaRetail China Trust (“CRCT”) was listed on the Singapore Exchange Securities Trading Limited on 8 December 2006. CRCT is sponsored by CapitaLand Limited (“CapitaLand” or the “Sponsor”), one of the largest listed real estate companies in Asia.

CRCT was established with the investment objective of investing on a long term basis in real estate used primarily for retail purposes and located primarily in China, Hong Kong and Macau. CRCT was established as a private trust on 23 October 2006 under a trust deed entered into between CapitaRetail China Trust Management Limited (“CRCTML” or the “Manager”) and HSBC Institutional Trust Services (Singapore) Limited (the “Trustee”). CRCT’s external manager, CRCTML, is a wholly-owned subsidiary of CapitaLand. In addition, CapitaLand maintains a substantial ownership in CRCT, as with its other sponsored REITs (see About the Sponsor.)

At IPO, CRCT comprised of seven retail malls with a total of 453,000 square meters, in five Chinese cities. The malls were in Beijing, Huhehaote, Zhengzhou, Shanghai, and Wuhu. Their anchor tenants included strong credit retailers such as Wal-Mart from the US, Carrefour from France and the Beijing Hualian Group. The malls are positioned as one-stop family-oriented shopping, dining and entertainment destinations in their localities. CRCT also aims at significant asset enhancement opportunities through reconfiguration of retail units, improvement of tenancy mix, conversion of ancillary areas into productive retail space and other proactive asset management initiatives.\(^{26}\)

CRCT is an example of a cross border REIT. A cross border REIT is one that invests in real estate assets in one or more countries outside its home base. Therefore, in a cross border REIT, the origin of the sponsor is not a relevant factor in determining the cross-border status. The rationale of a cross border REIT has the two-fold benefit of exporting expertise in managing assets and maximizing the institutional/ tax advantages in the listing countries. The Singapore government introduced a tax

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exemption for foreign-sourced interest and foreign trust distributions to encourage more cross border REITs to list in the country. This tax exemption attempts to minimize any tax leakage that could happen for these vehicles.\textsuperscript{27}

The structure of CRCT, illustrated below in the chart, has some unique characteristics. The structure is a reflection of the Chinese jurisdiction that disallows 100 percent foreign ownership of real estate. A project company is set up for each retail mall in the portfolio. The project company is structured as a Wholly Foreign Owned Enterprise (“WFOE”) in China, which holds the Chinese assets directly\textsuperscript{28}. An offshore company is incorporated in Barbados to receive rental incomes generated in China and distribute dividends to unit holders. Barbados is chosen as the location of the offshore company due to the tax treaty between China and Barbados that allows payments of dividends by a WFOE to its foreign owners to be free of Chinese withholding tax. In turn, incomes and expenses are operated as two independent cash flows and netted out once a year (Luo, 2008).

There is a unique governance risk that CRCT may not have full control, through the relevant Barbados Company, of the project companies in which they don’t hold 100 percent of ownership. As China laws require unanimous approval of the board of the relevant Project Company for certain matters, CRCT is subject to the decisions of directors appointed by other joint venture partners of the project companies\textsuperscript{29}.

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\textsuperscript{27} Other cross border REITs in Asia include, Fortune REIT, GZI REIT, First REIT, Mapletree-Lippo REIT and several others. Majority of the cross border REITs are based in Singapore.

\textsuperscript{28} A WFOE is a limited liability company wholly owned by foreign investor(s) typically with a limited duration. In China, WFOEs were originally conceived of for encouraging manufacturing activities that were either export orientated or that introduced advanced technology. However, with China’s entry into the WTO, these conditions were gradually abolished and the WFOE is increasingly being used for service providers such as a variety of consulting and management services, software development and trading as well. The liability of the shareholders of the WFOE is limited to the amount of subscribed capital.

\textsuperscript{29} The matters needing unanimous approval of the board include the amendment of the relevant Project Company’s articles of association, the increase or reduction or transfer of the registered capital of the relevant Project Company, the merger or division of the relevant Project company and the winding up of the relevant Project Company.
Figure 11: CapitaRetail China Trust Structure

Source: CapitaRetail China Trust Prospectus, 2006.
About the Sponsor – CapitaLand Limited

CapitaLand, a public company traded on the Singapore Stock Exchange, manages more than S$50 billion of assets, including over S$24 billion in 5 REITs and 17 private equity real estate funds. Temasek Holdings, one of Singapore’s Sovereign Wealth Funds, owns 40 percent of CapitaLand, hence, categorizing CapitaLand as a government-linked corporation (“GLC”). GLCs are companies in which more than 20% of their shares are owned by the Singapore government. Most of these companies were established in the 1960s and 70s, primarily to facilitate Singapore’s economic development in specific sectors.  

CapitaLand is also involved in other retail property business through CapitaLand Retail Limited, the retail property arm and wholly-owned subsidiary of CapitaLand, the two retail private equity funds that CapitaLand manage, CapitaRetail China Development Fund and CapitaRetail China Incubator Fund, and the Singapore retail asset REIT, CapitaMall Trust.

CapitaLand, at the time of CRCT’s IPO, had established three pioneering REITs listed in Singapore — (1) CapitaMall Trust, the first REIT in Singapore, (2) CapitaCommercial Trust, the first commercial REIT in Singapore and (3) Ascott Residence Trust, the first serviced residence REIT in Asia. The following is the corporate structure of CapitaLand.

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30 The Temasek Charter issued by the Singapore government on July 3, 2002 divides GLC (government-linked companies) that will continue to be owned and controlled by Temasek into Group A and Group B businesses. Group A businesses are those that involve either “ownership of a resource that is critical to Singapore’s security or economic well-being” or “a natural domestic monopoly for which a market-based regulatory framework has not yet been established” and Group B businesses are those with regional and international potential.

31 Refer to Appendix X for more information on the Sponsor.
As mentioned, CapitaLand maintains partial ownership in each of their sponsored REITs. The percentage ownership maintained in each REIT is shown below.

*Figure 13: CapitaLand REIT ownership*

*Source: CapitaLand corporate website*
4.2 Performance and Valuation at IPO

As at 30 September 2006, the assets held by CRCT were valued at RMB 3,792,000,000 (S$757,021,029) by Knight Frank, the independent appraiser appointed by the Trustee. The valuation was used as basis for the initial offering price of S$1.13 per unit. The institutional tranche of CRCT’s IPO was 196 times over-subscribed\(^\text{32}\).

At the date of the global offering, more than 282,000,000 units were distributed to five strategic investors at S$0.981 per share. Institutional investor constitutes 59.4% of the ownership while individual investor accounts for the rest 40.6%.

The following table and charts show the summary valuation statistics at time of CRCT’s IPO and CRCT’s post-IPO performance.

Figure 14: Summary Valuation Statistics

<table>
<thead>
<tr>
<th></th>
<th>Valuation by CBRE (as at 30 September 2006)</th>
<th>Valuation by Knight Frank (as at 30 September 2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>RMB3,451,000,000  (S$688,945,035)</td>
<td>RMB3,792,000,000  (S$757,021,029)</td>
</tr>
<tr>
<td>Implied net asset value per unit based on valuation by CBRE</td>
<td>S$0.98</td>
<td></td>
</tr>
<tr>
<td>Offering Price</td>
<td>S$1.13 per Unit</td>
<td>RMB3,792,000,000  (S$757,021,029)</td>
</tr>
<tr>
<td>Implied purchase price(^\text{(1)}) of the Properties at the Offering Price of S$1.13 per Unit</td>
<td>RMB3,792,000,000  (S$757,021,029)</td>
<td></td>
</tr>
<tr>
<td>Premium to net asset value per Unit at the Offering Price of S$1.13 per Unit</td>
<td>15.3%</td>
<td></td>
</tr>
</tbody>
</table>

\(^{(1)}\) The implied purchase price of the Properties is derived from the Offering Price (as defined herein) which includes the total Underwriting, Selling and Management Commissions, as well as other estimated offering expenses. Such expenses have been paid by the Vendor and the other Strategic Investors to the Trustee when they subscribed for Units as a Strategic Investor during the private trust stage.

\(^{32}\) This does not include the strategic investors.
1. The forecast is based on the forecast shown in CRCT Prospectus (the “Prospectus”) dated 29 November 2006.
2. YTD 2007 includes private trust period from 23 October 2006 to 7 December 2006 (“Private Trust Period”) and public trust period from the date of listing on 8 December 2006 (“Listing Date”) to 31 March 2007.
3. As disclosed in the Prospectus, the first distribution after the Listing Date will be for the period from the Listing Date to 30 June 2007 and will be paid by the manager on or before 30 September 2007.
4. N.M.-not meaningful

Source: CRCT Prospectus and CRCT 1Q2007 Results
CRCT’s income available for distribution 1Q 2007 was S$7.17 million. This was S$0.63 million or 9.5% higher than the forecast per CRCT’s prospectus.

Since listing in December 2006, CRCT’s unit price has appreciated by a remarkable 176.1% from its initial offering price of S$1.13 per unit. This compares more than favorably with other broader indices like the Straits Times Index and the Singapore Property Equities Index, which had risen 11.4% and 29.3% in the corresponding period respectively. While the strong share price performance is partly attributable to investors’ confidence in “the long-term strategy which is well-supported by a proprietary pipeline of assets and proven on-ground delivery capabilities”, as quoted by chairman of CRCTML another underlying reason for strong share price performance may be in part due to investors’ confidence in the governance structures of the REIT.

The following section examines the corporate governance mechanisms in place for CRCT and contrasts them with the US REIT corporate governance mechanisms that were discussed in Chapter 2.

4.3 CRCT Governance Mechanisms v. US REIT Governance Mechanisms

i. Board Structure and Composition

There is no separate board for CRCT, but an executive committee and audit committee. Hence in examining the corporate governance of the board of CRCT, it is most relevant to use the board of the manager, CRCTML, as the proxy. The board of CRCTML established a framework for the management of the CRCTML and CRCT, including a system of internal control and a business risk management process. CRCTML follows the unitary or one-tier board structure commonly used in the US where the emphasis is on the unit holder.

The following is a statement of the board:

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33 Based on CRCT closing unit price of S$3.12 on 30 March 2007
The Board of Directors of the manager is responsible for the overall corporate governance of the Manager including establishing goals for management and monitoring the achievement of these goals. The Manager is also responsible for the strategic business direction and risk management of CRCT. All Board members participate in matters relating to corporate governance, business operations and risks, financial performance and the nomination and review of Directors (CRCT Prospectus).

The board structure and composition of CRCTML entails:

- Four Independent Directors, one Executive Director and four Non-Executive Directors.
- The Executive Director holds the position of Chief Executive Officer of CRCTML.
- The positions of Chairman of the board and CEO are separate.
- There are separate Audit and Compensation Committees.

The separation of the roles of the Chairman and the Chief Executive Officer provides a healthy professional relationship between the Board and the management of CRCTML, with clarity of roles and robust oversight as they deliberate on the business activities of the manager. The Chairman is responsible for the overall management of the Board, as well as ensuring that the members of the Board and the management work together with integrity and competency, and that the Board engages the management in constructive debate on strategy, business operations, enterprise risk and other plans while the Chief Executive Officer has full executive responsibilities over the business directions and operational decisions in the day-to-day management of the Manager.  

A board system with majority non-executive or independent members has the benefit of allowing the management to benefit from external, diverse and objective perspective on issues that are brought before the board. The candidates for the board are put forward or sought through an informal/formal contacts and recommendations. According to the manager, “It would also enable the board to interact and work with the management through a robust exchange of ideas and views to help shape the strategic process.” While having the majority of the directors that are either non-executive or independent of the management of CRCTML has the above benefits.

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34 CRCT Prospectus 2006.
it appears that the directors are independent of CRCTML, but not completely independent of CapitaLand – the parent and the sponsor. Closer inspections of the biographies of the directors show that many of them also either hold other positions with CapitaLand or sit on boards of other CapitaLand affiliates. There is little or no governance in place to prevent the directors from sacrificing the performance of one CapitaLand-sponsored REIT for another CapitaLand-sponsored REIT. This is an area that could benefit from more disclosure. A reform of regulations could help set some the tone for increasing the measure of independence or at least allow minority shareholders as a bloc to appoint directors, and have a say with regards to the directors’ ongoing appointment.
In the US, REITs span the range from large capitalization public REITs with efficient, fully integrated operations, to private REITs closely held by founding members. REITs of the former nature or REITs with aspirations for institutional inflows of capital typically have boards that have higher percentage of independent directors to provide stronger non-executive oversight on behalf of investors.
The following diagram shows the management reporting structure of the board.

**Figure 18: Management Reporting Structure of the Board**

![Diagram showing the management reporting structure of the board]

**Pro:** Separation of roles of Chairman and Chief Executive Officer to provide check and balance for the management of CRTCML.

**Con:** The board consists of directors that also hold board positions in other REITs that are sponsored by CapitaLand. Disclosure of individual incentives is not clear.

*Source: CRCT Prospectus*
Ownership

More than half of the units issued for the CRCT IPO were to strategic investors at a discount to the S$1.13 public price. The strategic investors -- the Vendor, Retail Crown Pte Ltd, CapitaMall Trust (“CMT”), Stichting Pensioenfonds voor de Gezondheid, Geestelijke en Maatschappelijke Belangen (“PGGM”), and Great Eastern Life -- were issued units at a price of S$0.981. The practice of extending discounts to the public offering price for strategic institutional investors has since been prohibited by the Monetary Authority of Singapore in 2007. While REIT managers contend that the discounts allow them to establish a stable investor base, the MAS’ rationale for the change is that the differential pricing would disadvantage retail investors.

In the US, differential treatment of shareholders exists with different classes of investors. In the UPREIT structure, holders of partnership units and REIT stock are accorded different control and cash flow rights. In the case of the CRCT IPO, none of the strategic investors were granted any special rights under the trust deed distinct from the rights enjoyed by any other unit holder under the trust deed. The use of preferred shareholdings can be used by SREITs, but is not in the case of CRCT.

At IPO (assuming that the over-allotment option was not exercised) strategic investors constituted 59.4% of the ownership while other public and institutional investors accounted for 40.6%. Comparing the US REIT ownership rules of five-or-fewer to the CRCT IPO, CRCT is consistent with this rule in diversifying its ownership base to have at least five investors hold

35 The strategic investors are:
1. Retail Crown Pte. Ltd. (20%) 
2. The Vendor (6.1%): both the Vendor and the Retail Crown Pte. Ltd. are owned indirectly by the Sponsor -- CapitaLand Limited - through CRTL and CapitaLandRetail China. 
3. CMT (20%) is the first real estate investment trust to be listed on the SGX-ST 
4. PGGM (10%) is a pension fund for employees in the healthcare and social welfare sectors which was established in 1969 in the Netherlands. The pension fund invests largely in fixed income, equities, private equity, real estate and commodities, both in the Netherlands and elsewhere. 
5. Great Eastern (3.3%) is the largest insurance group in Singapore and Malaysia. It is the only life insurance company to be listed on the SGX-ST, and the largest insurance company in Southeast Asia in terms of assets and market capitalization.

58
50% of the outstanding units of the REIT\(^\text{36}\). The Singapore REIT law requires that at least 25% of the outstanding units must be held by at least 500 public shareholders, a variant of the five-or-fewer law in the US – prior to this IPO it was also expected that CRCT would be consistent with this law.

The following table sets out the principal unit holders of CRCT and their unit holdings.

**Figure 19: Ownership of CRCT Units**

<table>
<thead>
<tr>
<th>Units owned as at the date of this Prospectus (%)</th>
<th>Units owned after the Offering on the Listing Date (assuming that the Over-allotment Option is not exercised) (%)</th>
<th>Units owned after the Offering on the Listing Date (assuming that the Over-allotment Option is exercised in full) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Crown Pte. Ltd.(^\text{1})</td>
<td>95,130,513 20.0</td>
<td>95,130,513 20.0</td>
</tr>
<tr>
<td>The Vendor(^\text{1})</td>
<td>222,100,000 46.7</td>
<td>28,800,000 6.1</td>
</tr>
<tr>
<td>CMT(^\text{2})</td>
<td>95,100,000 20.0</td>
<td>95,100,000 20.0</td>
</tr>
<tr>
<td>PGGM</td>
<td>47,600,000 10.0</td>
<td>47,600,000 10.0</td>
</tr>
<tr>
<td>Great Eastern</td>
<td>15,700,000 3.3</td>
<td>15,700,000 3.3</td>
</tr>
<tr>
<td>Public and institutional investors(^\text{3})</td>
<td>0 0.0</td>
<td>193,300,000 40.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>475,630,513</strong> 100.0</td>
<td><strong>475,630,513</strong> 100.0</td>
</tr>
</tbody>
</table>

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36 As a pension fund, PGGM is considered to qualify through the look through provisions of constituting more than one single investor.
partial ownership of CMT, further increasing its stake in CRCT’s performance. As an extra signal of faith to the investors, the sponsor has also set in place two lock-up periods for its units. The first lock-up period is with respect to all the units held by the sponsor and spans 180 days after the initial public offering date. The second lock-up period is with respect to half the units held by the sponsor and spans 360 days after the first lock-up period.  

In Singapore, REIT sponsors often retain substantial control of SREIT shares after IPOs and an independent asset management subsidiary is typically set up by sponsors to render fee-based management services to REITs. In essence, CapitaLand is able to benefit from both equity participation in their sponsored REIT and the management fees related to each REIT. These REITs are commonly known as captive REITs. In the US, the close relationship between sponsors and management companies in captive REITs creates potential sources of agency problems, which include over-paying for properties unloaded by sponsors. Given the high agency costs associated with captive REITs, evidence in the US has pointed to the significant underperformance of captive REITs.

CapitaLand attempts to re-align the interests of the sponsors and investors by continuing to hold stakes in their sponsored REITs. These controlling stakes of CapitaLand can be construed as a strong signal on the part of CapitaLand to act in good faith so as to preserve its reputation, and at the same time, minimize the financial and operational risks in REITs. Outside investors also acknowledge this signal and put their confidence into the REITs with controlling stakes from sponsors. While the external management fee-based structure of CapitaLand presents agency costs, CapitaLand’s equity participation in CRCT helps to mitigate these associated costs. Assurance is also additionally offered by the Singapore government’s investment in the REIT sector via CapitaLand (whose majority owner is Temasek Holdings)

37 The Sponsor has agreed to (a) a lock-up arrangement during the period commencing from 6 November 2006 until the date falling 180 days after the Listing Date (both dates inclusive) (the “First Lock-up Period”) in respect of all of the Units held by the Sponsor from the date and (b) a lock-up arrangement during the period commencing from the day immediately following the First Lock-up Period until the date falling 360 days after the Listing Date (the “Second Lock-up Period”) in respect of 50.0% of the Lock-up Units, subject to certain exceptions.
**Pros:** Consistent alignment of sponsor’s interest with REIT shareholders through significant sponsor’s stake in CRCT. Shareholder ownership base is diversified according to the equivalent five-or-fewer rule.

**Cons:** High ownership of REIT by sponsor makes it hard for investors to distinguish between the share price movements of the REIT with that of the sponsor.

iii. Compensation

Compensation can refer to salary and bonus paid to individuals of the REIT, as well as, management fees paid to the REIT manager. In the case of CRCT, the most important measure to be evaluated in terms of corporate governance is that of the external REIT manager, CRCTML. Externally-managed REITs face unique agency costs that require that the flows of services and funds between the REIT and the manager to be transparent.

The fees that CRCTML is entitled to include a base fee of 0.25% per annum on the value of CRCT’s deposited property\(^{38}\), a performance fee of 4.00% per annum of the Net Property Income in relevant financial year, an investment management fee of 0.5% of the value of authorized investments\(^{39}\), an acquisition fee of 1.0-1.5% (depending on size of investment)\(^{40}\), and a divestment fee of 0.5% of the sale price of assets. These fees are consistent with the industry standard in Singapore. In the US, these costs of these activities are internalized within the REIT.

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\(^{38}\) Excluding investments in the nature of real estate held directly by CRCT or indirectly through one or more Special Purpose Vehicles

\(^{39}\) Authorized Investments which are not real estate either held directly or indirectly (unless such Authorized Investment, which is not real estate, is an interest in a property fund (either a real estate investment trust or private property fund) wholly managed by a wholly-owned subsidiary of the Sponsor for which no Authorized Investment Management Fee will be payable).

\(^{40}\) (i) up to 1.5% of the purchase price in the case of any Authorized Investment acquired by CRCT for less than S$200.0 million and (ii) 1.0% of the purchase price in the case of any Authorized Investment acquired by CRCT for S$200.0 million or more
As an additional check and balance to these fees, any increase in the rate above the permitted limit or any change in the structure of these fees must be approved by a resolution proposed and passed by a majority consisting of 75.0% or more of the total number of votes cast for and against such resolution at a meeting of the unit holders. The disclosure and transparency of the compensation structure ensure that any arrangements not beneficial to unit holders can be discovered. Ongoing monitoring is also facilitated by regular financial statements publicly issued.

As set forth earlier, compensation, like ownership-related practices, help define incentives and whether the interests of shareholders and managers are aligned and whether the board is an effective check on management. For CapitaLand, the management fees payable to the manager, CRCTML have a performance-based element which is designed to align the interests of the Manager with those of the unit holders, and incentivize CRCTML to grow revenues and minimize operating costs.

However, it should also be noted that there may be difficulty in removing CRCTML as the manager of CRCT. Given that the Singapore Property Funds Guidelines require the removal of a Manager of a real estate investment trust to be approved by the unit holders by way of passing an ordinary resolution, without any unit holder being disenfranchised or deprived the right to vote. Hence, it may be difficult for the manager (being an indirect wholly-owned subsidiary of the Sponsor) to be removed.

In the US experience, analysts for Moody’s have found that external management structures effectively lock REITs into outsourcing management services to a particular external manager, and create real barriers to change. Externally managed REITs have few, if any, employees. Instead, the external manager provides employees to the REIT as part of the services agreement.
Such a structure presents a major obstacle to REITs if they wish to cancel the services agreement with the external manager, because such a change requires a wholesale change in management and the employees at large. With CRCT, the entangling of the manager and the REIT is most apparent due to their common owner.

**Pros:** Performance-based fees to align the interests of CRCTML with investors in CRCT.

**Con:** Difficulty in removing CRCTML as manager of CRCT due to ownership of both entities being linked at a higher level.

iv. Takeover Defenses

CRCT, like all REITs, in Singapore do not have poison pill provisions, which generally reflect negatively on a company’s stock price. In the time of the IPO of CRCT, the rights of minority shareholders were not protected by the REIT legislation or provisions written into CRCT’s governance.

The prevailing standards in the Singapore REIT IPO market at that time were consistently lacking in takeover defenses. At the time of IPO, the Singapore Code on Takeovers and Mergers and the provisions of Sections 138 to 140 of the Singapore Securities and Futures Act did not apply to acquisitions of SREIT units. Hence, the rights of the unit holders of CRCT were not identical to those granted to holders of shares in companies incorporated in Singapore.

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41 “Corporate Governance of Externally Managed REITs Presents Credit Risks” by Moody’s, November 2007
In June 2007, a change was made to extend the legislation to include SREITs. The change not only protects the interests of minority investors but also that of the incumbent controlling unit holders. In the absence of a proper framework governing take-over and merger transactions of REITs, a party would be able to accumulate effective control of a REIT without having to make a general offer. Under such circumstances, incumbent controlling unit holders might not be able to extract a control premium from such party. The amendment has forced acquirers to engage in negotiation with the REIT and help preserve the value of unit holders’ investment. The Singapore legislation now more closely resembles that of the UK, Australia and US.

**Pro:** New legislation provide some minority and controlling shareholder protections.

**Con:** Initial legislation failed to protect interests of minority investors; however, this was later mitigated by the change in legislation in June 2007.

v. Other – Related Party Transactions

The nature of the contractual agreements between the sponsor, CapitaLand, the manager, CRCTML, and the REIT, CRCT, can lead to non-arm’s-length transactions, or self-dealing. This is especially pronounced in the case of CRCT and other externally managed REITs where the parties are all distinct entities with distinct economic incentives. These incentives may or may not overlap. In mitigating the conflict of interest that can arise, CRCT has put in place certain important contractual agreements with CapitaLand and CRCTML.

First, CRCTML may not manage any other REIT which invests in the same type of properties as CRCT. Second, the right of first refusal (ROFR”) over acquisition of properties from related parties is extended to CRCT. This contractual arrangement helps to mitigate the conflict of interest that arises from the similar businesses that CapitaLand also operates. The ROFR is for properties in two CapitaLand-sponsored private retail property funds, namely, CapitaRetail
China Development Fund\(^{42}\) and CapitaRetail China Incubator Fund\(^{43}\), and also properties under CapitaLand Retail Limited\(^{44}\), the retail property arm and wholly-owned subsidiary of CapitaLand.

To enforce the above, CRCTML has established an internal control system to ensure that all future related party transactions will be undertaken on “normal commercial terms and will not be prejudicial to the interests of CRCT and the unit holders.”

As a general rule, the Manager must demonstrate to its Audit Committee that such transactions satisfy the foregoing criteria, which may entail obtaining (where practicable) quotations from parties unrelated to the Manager, or obtaining one or more valuations or appraisal reports from independent professional valuers (in accordance with the Singapore Property Funds Guidelines).

In case of CRCT, the role of the audit committee is particularly important due to many opportunities for self-dealing to occur between the related parties. CRCT’s prospectus specifies that the audit committee will review all related party transactions to ensure compliance with CRCTML’s internal control system and with the relevant provisions of the Singapore Listing Manual, as well as, the Property Funds Guidelines. The review is to include the examination of the nature of the transaction and its supporting documents. If a member of the audit committee

\(^{42}\) CapitaRetail China Development Fund (“Development Fund”) is a private fund established by CapitaLand to invest primarily in greenfield retail mall developments in China. It has raised a committed capital of US$600.0 million and will grant a right of first refusal to CRCT over properties which it proposes to sell. Pursuant to its joint venture with Shenzhen International Trust & Investment Co., Ltd (“SZITIC”), CapitaLand has secured for investment by the Development Fund, a portfolio of 19 retail mall developments across China, comprising over 900,000 sq m of aggregate gross floor area and an aggregate value of approximately US$900.0 million with SZITIC and its subsidiaries and associates (the “SZITIC Group”).

\(^{43}\) CapitaRetail China Incubator Fund (“Incubator Fund”), another private fund established by CapitaLand to warehouse completed retail malls in the PRC for repositioning, asset enhancement or leasing to increase occupancy rates and which has raised committed capital of US$425.0 million, will grant a right of first refusal to CRCT over properties which it proposes to sell.

\(^{44}\) CapitaLand, through its retail property arm and wholly-owned subsidiary, CapitaLand Retail Limited (“CRTL”), will grant first to CRCT, and then to the Incubator Fund, a right of first refusal over future completed retail properties located in China which are identified and targeted for acquisition by CRTL or its subsidiaries.
has an interest in a transaction, he or she is to abstain from participating in the review and approval process in relation to that transaction\textsuperscript{45}.

For all related-party transactions, strong disclosure requirements by CRCT are enforceable. The CRCT prospectus mandates that CRCTML is to maintain a register to record all Related Party Transactions which are entered into by CRCT and the basis, including any quotations from unrelated parties and independent valuations obtained to support such bases, on which they are entered into. This is a positive signal to investors of transparency. REITs in Singapore are increasingly moving to this standard.

While CRCTML has put in place governance structures to make sure that these conflicts are handled in the “best” manner possible, there may be technical, regulatory or informational reasons why the agency problem can’t be completely solved with the externally managed REIT structure. However, regardless of the REIT management structure, there should be as much disclosure as possible to mitigate the conflict. If the governance system is better relative to other SREITs, then there will assume to be a premium conferred by the market.

Until 1986, internal management of REITs was not permitted in the US. However, once the REIT legislation was amended to allow for internal management, most REITs restructured themselves to be self managed while new REITs predominantly picked the internal management structure. While literature in the US supports the view that internal management is more efficient, the institutional setting of the new REITs in Asia and their success will support the dominant model of the future. Both formats should be allowed in letting the market decide which one preferred.

**Pros:** Right of first refusal extended to CRCT. Audit committee to provide oversight of any related party transactions. High level of transparency and disclosure frequency.
Con: Agency costs can’t be completely resolved, only mitigated with appropriate governance structures and monitoring mechanisms. Often the ultimate decision is based on the trade-offs between higher efficiency and higher costs of providing transparency.
Corporate governance structures are essential for a well-developed, functioning marketplace. The presence of a good, effective corporate governance system helps to instill confidence in the market and facilitate a more information-efficient economy, both of which are the underpinnings of economic growth, whether in Asia or globally. Many Asian countries have transparency problem that inhibit international investment inflows. According to Jones Lang LaSalle’s Real Estate Transparency Index, only Hong Kong, Singapore and Malaysia are ranked as high as Tier Two in Asia. Other Asian countries are reckoned to have very serious transparency problems and are classified in Tiers Three through Five. The US is ranked in Tier One.

On the firm level, the design of sound corporate governance mechanisms is critical for REITs that are preparing to go public. At the industry level, issues of transparency and corporate governance are consequential to the further development of REITs in Asia. This study looks at various REIT regimes and corporate governance systems around the world. It then proceeds to examine the governance structures in place at the time of an IPO in the emerging REIT market of Singapore.

The case study of one of CapitaLand’s REIT vehicles, CapitaRetail China Trust, highlights the differences that still exist between the US and evolving Asian REIT models and in turn, the relevant corporate governance structures. Importantly, this study finds that governance structures are not a “one size fits all” theory and must be tailored to fit the appropriate institutional context.

Several corporate governance mechanisms were examined in CRCT’s IPO to find their connection to a firm’s value. It was found that while the separation of roles of Chairman and Chief Executive Officer to provide check and balance for the management of CRTCML was an advantage, the board should attempt to provide higher disclosure of each individual’s director’s incentives as to their multiple board positions in other REITs sponsored by CapitaLand. A more diverse and independent board could better help to protect the interests of the shareholder base.
The shareholder ownership base of CRCT at IPO was also found to be appropriately diversified according to the equivalent five-or-fewer rule from the US. However, the high ownership of CRCT by CapitaLand makes it hard for investors to distinguish between the share price movements of the REIT with that of the sponsor. It would appear that in the absence of more distinct governance structures that much of investors’ assurance is offered by the faith of the Singapore government’s dollars behind the REIT sector. The Singapore government owns a significant stake in CapitaLand, via the state investment fund, Temasek, which in turn holds 40 percent of CapitaLand’s equity. CapitaRetail China Trust is part of a group of pioneering REITs in Asia that helped to set benchmarks for other countries to follow. The assurance of the Singapore government has greatly helped to foster growth in SREITs; however as the market matures and the number of private players entering increase, governance structures will need to evolve to match the different institutional context of these new SREITs.

External management format in the case of CRCT creates agency costs, some of which can be mitigated with contractual arrangements such as a right of first refusal on deals, strong audit standards, and a high level of transparency and disclosure frequency. CapitaLand’s substantial equity participation in CRCT may help to mitigate the associated agency costs with the external fee-based manager. New SREITs may not be able to duplicate the same ownership and cross holding structures of CapitaLand, in which case stronger clauses should be written in to allow shareholders the ability to remove the external manager when appropriate. While external management is most prevalent, this situation is not a static one as governments in the region have proved their ability to adapt quickly to the market’s needs. Legislation should be reformed to allow both internal and external structures to exist, thus encouraging the market to make its choice in terms of the preferred management format. Currently of the emerging REIT markets, only Hong Kong allows both formats.

The closely-held nature and cross-shareholding structures between CapitaLand’s REIT vehicles, in aligning interests of sponsor, management REIT shareholders, have been able to mitigate the agency costs of external management thus far. However with the introduction of new players, the possibility of new management formats and ownership structure, and the increasing investor participation in REITs as an asset class, more protection for minority shareholders will be
needed. REITs should be required to implement a voting system which ensures that at least one member of the board of directors be appointed out of a list of candidates to be submitted by minority shareholders. Additionally as a remedial measure, minority shareholders should be able to initiate liability action against directors if they were not found to be acting in the best interests of shareholders.

Agency costs can’t be completely resolved, only mitigated with appropriate governance structures and monitoring mechanisms. As an investment vehicle, REITs have leveled the playing field for access to real estate for investors all around the world. With the fastest urbanization rates in the world, the potential for the shift of real estate from the private to public realm in Singapore and the rest of Asia is tremendous. However, when it comes to corporate governance, is the world truly flat? The institutional context in which US REITs and emerging REITs originate is unique and different. Even within each emerging REIT country in Asia, the context is also different. Singapore’s landscape is one dominated by a high percentage of GLCs. Hong Kong’s landscape has its own brand of small government, low taxes capitalism to which REITs might not necessarily offer tax advantages for investors. Thailand’s, Korea’s, and Malaysia’s landscape are all typically dominated by a handful of family-controlled conglomerates. The most appropriate governance structure is one that both allows REITs to flourish, protect shareholders, and in turn rewards these same shareholders. Regardless of the ultimate choice of governance structure, transparency and disclosure are always going to be the cornerstones of the mechanisms.
BIBLIOGRAPHY


Brody, Michael J., “Doing Business with REITs and Joint Ventures” 2007 ICSC Law Conference.


Huang, Yasheng. “China’s Private Sector Development In the Real Estate Sector”. MIT Sloan School of Management. 2007.


APPENDIX I: US REIT Qualification Criteria  
(Source: EPRA REIT Report 2008)

### Shareholder requirements / listing requirements

<table>
<thead>
<tr>
<th>Shareholder requirements</th>
<th>Listing mandatory</th>
</tr>
</thead>
<tbody>
<tr>
<td>- At least 100 shareholders</td>
<td>No</td>
</tr>
<tr>
<td>- Five or fewer individuals or foundations may not hold more than 50% of the shares</td>
<td></td>
</tr>
<tr>
<td>- No restriction on foreign shareholders</td>
<td></td>
</tr>
</tbody>
</table>

### Asset level / activity test

<table>
<thead>
<tr>
<th>Restrictions on activities / investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- At least 75% of its assets must be real estate, government securities or cash</td>
</tr>
<tr>
<td>- 75% asset test and 75% and 95% income tests</td>
</tr>
<tr>
<td>- Cannot own more than 10% of another corporation’s stock, other than in another REIT</td>
</tr>
<tr>
<td>or a taxable REIT subsidiary (ownership of a 100% owned ‘qualified REIT’ subsidiary is</td>
</tr>
<tr>
<td>ignored)</td>
</tr>
<tr>
<td>- No more than 5% of the value of its assets can be represented by securities of any one</td>
</tr>
<tr>
<td>issuer, other than another REIT or a taxable subsidiary (ownership of a 100% owned</td>
</tr>
<tr>
<td>‘qualified REIT’ subsidiary is ignored)</td>
</tr>
<tr>
<td>- Cannot own more than 20% (2009: 25%) of its assets in securities of one or more taxable</td>
</tr>
<tr>
<td>REIT subsidiaries</td>
</tr>
</tbody>
</table>

### Profit distribution obligations

<table>
<thead>
<tr>
<th>Operative income</th>
<th>Capital gains</th>
<th>Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 90% of its taxable ordinary income</td>
<td>Not required to distribute</td>
<td>Annually</td>
</tr>
</tbody>
</table>
APPENDIX II: Average Corporate Governance Quotient Ranked by Industry

*Source: Risk Metrics Group as of June 2, 2008*

<table>
<thead>
<tr>
<th>Industry Group</th>
<th>Average Index CGQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>68.9</td>
</tr>
<tr>
<td>Real Estate</td>
<td>56.4</td>
</tr>
<tr>
<td>Pharmaceuticals, Biotechnology &amp; Life Sciences</td>
<td>55.5</td>
</tr>
<tr>
<td>Semiconductors &amp; Semiconductor Equipment</td>
<td>54.3</td>
</tr>
<tr>
<td>Health Care Equipment &amp; Services</td>
<td>52.4</td>
</tr>
<tr>
<td>Banks</td>
<td>52.2</td>
</tr>
<tr>
<td>Automobiles &amp; Components</td>
<td>51.6</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>50.8</td>
</tr>
<tr>
<td>Insurance</td>
<td>50.6</td>
</tr>
<tr>
<td>Materials</td>
<td>50.5</td>
</tr>
<tr>
<td>Technology Hardware &amp; Equipment</td>
<td>50.5</td>
</tr>
<tr>
<td>AVERAGE</td>
<td>50.2</td>
</tr>
<tr>
<td>Transportation</td>
<td>50.2</td>
</tr>
<tr>
<td>Commercial Services &amp; Supplies</td>
<td>49.3</td>
</tr>
<tr>
<td>Food &amp; Staples Retailing</td>
<td>48.4</td>
</tr>
<tr>
<td>Software &amp; Services</td>
<td>48.1</td>
</tr>
<tr>
<td>Retailing</td>
<td>47.7</td>
</tr>
<tr>
<td>Telecommunication Services</td>
<td>47.2</td>
</tr>
<tr>
<td>Diversified Financials</td>
<td>47</td>
</tr>
<tr>
<td>Consumer Durables &amp; Apparel</td>
<td>46.8</td>
</tr>
<tr>
<td>Consumer Services</td>
<td>45.6</td>
</tr>
<tr>
<td>Energy</td>
<td>45.2</td>
</tr>
<tr>
<td>Food, Beverage &amp; Tobacco</td>
<td>40.8</td>
</tr>
<tr>
<td>Household &amp; Personal Products</td>
<td>38.3</td>
</tr>
<tr>
<td>Media</td>
<td>36.4</td>
</tr>
</tbody>
</table>
## APPENDIX III: Top 50 US Real Estate Companies, Ranked by Industry CGQ

*Source: Risk Metrics Group as of June 2, 2008*

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Ticker</th>
<th>Industry CGQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developers Diversified Realty Corp.</td>
<td>DDR</td>
<td>100</td>
</tr>
<tr>
<td>Regency Centers Corp.</td>
<td>REG</td>
<td>99.5</td>
</tr>
<tr>
<td>AMB Property Corp.</td>
<td>AMB</td>
<td>99</td>
</tr>
<tr>
<td>Parkway Properties, Inc.</td>
<td>PKY</td>
<td>98.5</td>
</tr>
<tr>
<td>U-Store-it Trust</td>
<td>YSI</td>
<td>98.1</td>
</tr>
<tr>
<td>Apartment Investment &amp; Management Co.</td>
<td>AIV</td>
<td>97.6</td>
</tr>
<tr>
<td>The St. Joe Company</td>
<td>JOE</td>
<td>97.6</td>
</tr>
<tr>
<td>Rayonier Inc.</td>
<td>RYN</td>
<td>96.6</td>
</tr>
<tr>
<td>Highwoods Properties, Inc.</td>
<td>HIW</td>
<td>96.1</td>
</tr>
<tr>
<td>UDR, Inc.</td>
<td>UDR</td>
<td>95.6</td>
</tr>
<tr>
<td>BRE Properties, Inc.</td>
<td>BRE</td>
<td>95.1</td>
</tr>
<tr>
<td>Duke Realty Corporation</td>
<td>DRE</td>
<td>94.7</td>
</tr>
<tr>
<td>Pennsylvania Real Estate Investment Trust</td>
<td>PEI</td>
<td>94.2</td>
</tr>
<tr>
<td>Ventas, Inc.</td>
<td>VTR</td>
<td>93.7</td>
</tr>
<tr>
<td>Plum Creek Timber Company, Inc.</td>
<td>PCL</td>
<td>93.2</td>
</tr>
<tr>
<td>Acadia Realty Trust</td>
<td>AKR</td>
<td>92.7</td>
</tr>
<tr>
<td>ProLogis</td>
<td>PLD</td>
<td>92.2</td>
</tr>
<tr>
<td>Cousins Properties Inc.</td>
<td>CUZ</td>
<td>91.7</td>
</tr>
<tr>
<td>Colonial Properties Trust</td>
<td>CLP</td>
<td>91.3</td>
</tr>
<tr>
<td>Liberty Property Trust</td>
<td>LRY</td>
<td>90.8</td>
</tr>
<tr>
<td>Equity Residential</td>
<td>EQR</td>
<td>90.3</td>
</tr>
<tr>
<td>Brandywine Realty Trust</td>
<td>BDN</td>
<td>89.8</td>
</tr>
<tr>
<td>Nationwide Health Properties, Inc.</td>
<td>NHP</td>
<td>89.3</td>
</tr>
<tr>
<td>Rait Financial Trust</td>
<td>RAS</td>
<td>88.8</td>
</tr>
<tr>
<td>PS Business Parks, Inc.</td>
<td>PSB</td>
<td>88.3</td>
</tr>
<tr>
<td>Entertainment Properties Trust</td>
<td>EPR</td>
<td>87.9</td>
</tr>
<tr>
<td>Lasalle Hotel Properties</td>
<td>LHO</td>
<td>87.4</td>
</tr>
<tr>
<td>CB Richard Ellis Group Inc</td>
<td>CBG</td>
<td>86.9</td>
</tr>
<tr>
<td>HCP Inc.</td>
<td>HCP</td>
<td>86.4</td>
</tr>
<tr>
<td>Felcor Lodging Trust Incorporated</td>
<td>FCH</td>
<td>85.9</td>
</tr>
<tr>
<td>First Potomac Realty Trust</td>
<td>FPO</td>
<td>85.4</td>
</tr>
<tr>
<td>Federal Realty Investment Trust</td>
<td>FRT</td>
<td>85</td>
</tr>
<tr>
<td>Northstar Realty Finance Corp</td>
<td>NRF</td>
<td>84.5</td>
</tr>
<tr>
<td>EastGroup Properties, Inc.</td>
<td>EGP</td>
<td>84</td>
</tr>
<tr>
<td>Anworth Mortgage Asset Corp.</td>
<td>ANH</td>
<td>83.5</td>
</tr>
<tr>
<td>National Retail Properties, Inc.</td>
<td>NNN</td>
<td>83</td>
</tr>
<tr>
<td>Cedar Shopping Centers, Inc.</td>
<td>CDR</td>
<td>82.5</td>
</tr>
<tr>
<td>Diamondrock Hospitality Company</td>
<td>DRH</td>
<td>82</td>
</tr>
<tr>
<td>Company Name</td>
<td>Ticker</td>
<td>Industry CGQ</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>--------</td>
<td>--------------</td>
</tr>
<tr>
<td>Health Care REIT, Inc.</td>
<td>HCN</td>
<td>81.6</td>
</tr>
<tr>
<td>Taubman Centers, Inc.</td>
<td>TCO</td>
<td>81.1</td>
</tr>
<tr>
<td>American Campus Communities, Inc.</td>
<td>ACC</td>
<td>80.6</td>
</tr>
<tr>
<td>Corporate Office Properties Trust, Inc.</td>
<td>OFC</td>
<td>80.1</td>
</tr>
<tr>
<td>Lexington Realty Trust</td>
<td>LXP</td>
<td>79.6</td>
</tr>
<tr>
<td>DCT Industrial Trust Inc.</td>
<td>DCT</td>
<td>79.1</td>
</tr>
<tr>
<td>Redwood Trust, Inc.</td>
<td>RWT</td>
<td>78.6</td>
</tr>
<tr>
<td>Simon Property Group, Inc.</td>
<td>SPG</td>
<td>78.2</td>
</tr>
<tr>
<td>Getty Realty Corp.</td>
<td>GTY</td>
<td>77.7</td>
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<tr>
<td>Post Properties, Inc.</td>
<td>PPS</td>
<td>77.2</td>
</tr>
<tr>
<td>American Financial Realty Trust</td>
<td>AFR</td>
<td>76.7</td>
</tr>
<tr>
<td>Jones Lang LaSalle, Inc.</td>
<td>JLL</td>
<td>76.2</td>
</tr>
</tbody>
</table>
APPENDIX IV: REIT Measures in the Global Market
Source: Ernst and Young: Global REIT Report 2008

1. Market Capitalization - Total per Region

- **North America**
  - 2008: 317,011
  - 2007: 408,135
  - 2006: 417,843

- **EMEIA**
  - 2008: 138,466
  - 2007: 157,644
  - 2006: 65,050

- **Pacific**
  - 2008: 80,900
  - 2007: 115,048
  - 2006: 79,238

- **Asia**
  - 2008: 68,330
  - 2007: 81,733
  - 2006: 46,036

2. Market Capitalization Average per REIT

- **North America**
  - 2008: 1,751
  - 2007: 1,665
  - 2006: 2,115

- **EMEIA**
  - 2008: 1,282
  - 2007: 1,642
  - 2006: 1,355

- **Pacific**
  - 2008: 1,124
  - 2007: 1,717
  - 2006: 1,321

- **Asia**
  - 2008: 776
  - 2007: 985
  - 2006: 687
3. Total rate of return – one year to 30 June 2008

North America

EMEIA

Pacific

Asia

4. Total rate of return – three year to 30 June 2008

North America

EMEIA

Pacific

Asia
5. Total debt to gross assets

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>66.59</td>
<td>61.53</td>
<td>56.35</td>
</tr>
<tr>
<td>EMEA</td>
<td>36.89</td>
<td>36.97</td>
<td>31.20</td>
</tr>
<tr>
<td>Pacific</td>
<td>39.47</td>
<td>43.28</td>
<td>33.41</td>
</tr>
<tr>
<td>Asia</td>
<td>40.98</td>
<td>42.62</td>
<td>32.14</td>
</tr>
</tbody>
</table>

6. Premium/discount of market price to net assets

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>45.87</td>
<td>102.96</td>
<td>81.77</td>
</tr>
<tr>
<td>EMEA</td>
<td>-21.64</td>
<td>86.65</td>
<td>18.19</td>
</tr>
<tr>
<td>Pacific</td>
<td>-32.08</td>
<td>59.84</td>
<td>14.21</td>
</tr>
<tr>
<td>Asia</td>
<td>-2.99</td>
<td>70.71</td>
<td>19.19</td>
</tr>
</tbody>
</table>

Percentage (%)
7. Regional dividend yield

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>5.40</td>
<td>5.26</td>
</tr>
<tr>
<td>EMEA</td>
<td>4.46</td>
<td>2.69</td>
</tr>
<tr>
<td>Pacific</td>
<td>5.72</td>
<td>6.10</td>
</tr>
<tr>
<td>Asia</td>
<td>3.89</td>
<td>5.75</td>
</tr>
</tbody>
</table>

8. Beta

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>1.02</td>
<td>0.91</td>
<td>0.86</td>
</tr>
<tr>
<td>EMEA</td>
<td>0.69</td>
<td>0.72</td>
<td>0.48</td>
</tr>
<tr>
<td>Pacific</td>
<td>0.92</td>
<td>0.57</td>
<td>0.55</td>
</tr>
<tr>
<td>Asia</td>
<td>0.82</td>
<td>0.55</td>
<td>0.46</td>
</tr>
</tbody>
</table>
# APPENDIX V: Legal Review of Asian REIT Regimes
*(Source: Luo Master’s Thesis 2008)*

<table>
<thead>
<tr>
<th>Asian REITs</th>
<th>Australia REIT</th>
<th>Singapore REIT</th>
<th>Japan REIT</th>
<th>South Korea REIT</th>
<th>Hong Kong REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enacted Year</td>
<td>1971</td>
<td>1999</td>
<td>2000</td>
<td>2001</td>
<td>2003</td>
</tr>
<tr>
<td>Legislation Law</td>
<td>Listed Property Trust (LPT), under the Australian Securities and Investment Commission</td>
<td>Unit Trust, under Singapore general securities laws and the Code for Collective Investment Schemes and Property Trust Guidelines</td>
<td>Closed-ended Corporation, under the Investment Trusts Law of Japan</td>
<td>General REIT; CR-REIT and Entrusted Management REIT (enacted in 2005), under the Investment Trust Law and Investment Corporation Law of South Korea</td>
<td>Unit Trust, under general laws of Hong Kong and the Code on Real Estate Investment Trusts.</td>
</tr>
<tr>
<td>Regulation Body</td>
<td>Australian Securities and Investment Commission</td>
<td>Monetary Authority of Singapore (MAS)</td>
<td>Financial Services Agency</td>
<td>Financial Supervisory Commission</td>
<td>Hong Kong Securities and Futures Commission</td>
</tr>
<tr>
<td>Management</td>
<td>External management</td>
<td>External management</td>
<td>Internal management</td>
<td>General REIT: internal CR.REIT; external Entrusted Management REIT: external</td>
<td>External management, independent from the trustee. Management and trustee may be part of the same corporate group if certain requirements are met.</td>
</tr>
<tr>
<td>Leverage</td>
<td>With thin capitalisation rules(^1), 75% of the adjusted Australian asset base, debt deduction will be reduced if exceeding the 75% leverage level.</td>
<td>35% of the deposited property value; may exceed 35%, up to 60% if a REIT has obtained a credit rating from Fitch, Moodys or Standard &amp; Poor then disclosed to the public. Continued disclosure of credit rating is required until leverage drop to 35% or below.</td>
<td>Unlimited. But lender must be an institutional investor to qualify for certain tax deductions.</td>
<td>200% of the net asset</td>
<td>45% of the gross assets value</td>
</tr>
<tr>
<td>Restrictions on Investment and Development Activities</td>
<td>Australia REIT</td>
<td>Singapore REIT</td>
<td>Japan REIT</td>
<td>South Korea REIT</td>
<td>Hong Kong REIT</td>
</tr>
<tr>
<td>-----------------------------------------------------</td>
<td>----------------</td>
<td>----------------</td>
<td>------------</td>
<td>------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Property trusts can hold investment properties indirectly through SPVs; unit trusts can invest offshore; public unit trusts can only take development activities to derive rental income.</td>
<td>Invest at least 35% of total assets in real estate; at least 75% of total assets in real estate and real estate-related assets; no more than 5% of total assets in any one issuer's securities or any one manager's fund; investment on vacant land and mortgages are NOT allowed; ≤ 10% of total assets can be invested in uncompleted non-residential property in Singapore or overseas.</td>
<td>JREIT can not invest overseas; invest only in &quot;Qualified Assets&quot;; can not hold 50% or more of the total issued shares of another company</td>
<td>General REIT: invest at least 70% of total assets in real estate, at least 10% in non real estate securities; CR-REIT: at least 70% of total assets in real estate. Entrusted Management REIT: at least 70% of total assets in real estate and 10% in real estate securities</td>
<td>can invest overseas; investment in hotels and recreational parks is permitted; cannot invest in vacant land or participate in development activities; must invest in income producing real estate except substantial redevelopment; if using SPVs, SPV must be 100% owned and with maximum of 2 layers (additional layers upon approval)</td>
<td></td>
</tr>
<tr>
<td>Minimum Real Estate Holding Period</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>General REIT: 3 years CR-REIT: no restriction Entrusted Management REIT: 3 years</td>
<td>2 years (may sell earlier subject to unitholder's approval)</td>
</tr>
<tr>
<td>Distribution of Taxable Income</td>
<td>100%</td>
<td>At least 90%</td>
<td>More than 90%</td>
<td>90% with excessive distribution possible for CR-REIT and Entrusted Management REIT</td>
<td>At least 90%</td>
</tr>
<tr>
<td>Restrictions on Unitholding</td>
<td>None</td>
<td>At least 500 public unitholders holding 25% of its units</td>
<td>Minimum 50 unitholders are qualified institutional investors; at least 50% of the units must be issued domestically, 3 or fewer unitholders cannot own more than 50% of the total stock value</td>
<td>General REIT: 30% public and each investor holds less than 30%; CR-REIT: no limitation on individuals, Entrusted Management REIT: minimum 30% public and each holds less than 30%</td>
<td>Minimum public float applies</td>
</tr>
<tr>
<td>Taxation at REIT Level</td>
<td>Australia REIT</td>
<td>Singapore REIT</td>
<td>Japan REIT</td>
<td>South Korea REIT</td>
<td>Hong Kong REIT</td>
</tr>
<tr>
<td>------------------------</td>
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</tr>
<tr>
<td>Subject to tax on dividend, capital gain on disposal of shares and income from foreign investments to domestic and foreign unitholders</td>
<td>Generally exempted; net income not distributed is subject to 46.5% tax in the hands of the trustee; net capital gain included in taxable income of the trust; withholding tax may apply to non-resident individuals and companies</td>
<td>Dividends are subject to 20% tax to domestic corporate; exempt to domestic individuals unless holding units as trading assets, 10% withholding tax to foreign non-individual unitholders</td>
<td>Subject to tax but distributions are deductible if certain requirements met; capital gain tax is treated the same as ordinary income; withholding tax applies to non-resident investors</td>
<td>General REIT: subject to regular corporate income tax; CR-REIT: exempted if more than 90% profit is distributed; Entrusted Management REIT: same as CR-REIT; no capital gain tax on listed REITs; withholding tax applies to both domestic and foreign unitholders</td>
<td>No income tax on income generating from overseas properties; SPVs are subject to 16% property tax or 17.5% profit tax; no capital gain tax; no withholding tax</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxation at Unitholder Level</th>
<th>Australia REIT</th>
<th>Singapore REIT</th>
<th>Japan REIT</th>
<th>South Korea REIT</th>
<th>Hong Kong REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subject to tax on dividend, capital gain on disposal of shares and income from foreign investments to domestic and foreign unitholders</td>
<td>Conduct valuation of each of SREIT's property assets by an appraiser at least once a year.</td>
<td>Conduct full valuation by an independent valuer</td>
<td>Conduct full valuation annually by an independent valuer; no valuer shall value the same H-REIT for three consecutive years</td>
<td>Not subject to Hong Kong tax unless on revenue from trade, profession or business carried on in Hong Kong</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Valuation</th>
<th>Australia REIT</th>
<th>Singapore REIT</th>
<th>Japan REIT</th>
<th>South Korea REIT</th>
<th>Hong Kong REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Conduct full valuation by an independent valuer.</td>
<td>Conduct full valuation by an independent valuer.</td>
<td>Conduct full valuation annually by an independent valuer; no valuer shall value the same H-REIT for three consecutive years</td>
<td>Not subject to Hong Kong tax unless on revenue from trade, profession or business carried on in Hong Kong</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mandatory Listing</th>
<th>Australia REIT</th>
<th>Singapore REIT</th>
<th>Japan REIT</th>
<th>South Korea REIT</th>
<th>Hong Kong REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Optional. Minimum of 500 unit holders each holding at least A$2,000 value of assets to be able to list on Australian Stock Exchange</td>
<td>Mandatory. Minimum of S$20 million of assets to be able to list on Singapore Stock Exchange</td>
<td>Optional. A number of requirements must be met to be able to list on a Japan Stock Exchange</td>
<td>Mandatory for General REIT; optional for CR-REIT; Mandatory for Entrusted Management REIT</td>
<td>Mandatory to list on Hong Kong Stock Exchange</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geographical Restriction</th>
<th>Australia REIT</th>
<th>Singapore REIT</th>
<th>Japan REIT</th>
<th>South Korea REIT</th>
<th>Hong Kong REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>None</td>
<td>May only invest in real estate in Japan</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Australia REIT</td>
<td>Singapore REIT</td>
<td>Japan REIT</td>
<td>South Korea REIT</td>
<td>Hong Kong REIT</td>
<td></td>
</tr>
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</tr>
<tr>
<td>In September 2007, changes of tax law were made, including foreign sourced income may pass through shareholders untaxed including from a taxable REIT subsidiary; allow managers to restructure to create active business subsidiaries.</td>
<td>MAS released a series of proposals intended to bolster REIT regulation. The measures include tighter disclosure requirements with regard to short-term financial engineering in the build up to an initial public offer. MAS is also floating the idea of doing away with the 5 percent single-party limit in conjunction with a recent announcement that takeover laws will now apply to REITs. Other changes may include anti-entrenchment rules that disallow or qualify long-term REIT management contracts and high termination fees.</td>
<td>within the next few months regulators are expected to allow J-REITs to invest in overseas properties.</td>
<td>(SFC) issued a guideline in October 2007 stating that REIT managers are able to expand into other markets or different property sectors without the need for SFC re-authorization, and are permitted to develop new investment strategies, including overseas activity, after listing. REIT managers are expected to adopt more ambitious growth strategies.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. The Thin Capitalization Rules: an Australian listed property trust is either foreign controlled or controls a foreign entity.
## APPENDIX VI: External Management Governance Risks and Mitigating Factors

*Source: Moody’s*

<table>
<thead>
<tr>
<th>Risk due to external management</th>
<th>Mitigant(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Structure creates significant hurdle to changing out external management</td>
<td>Specific performance metrics in service agreements; a strong focus on management’s performance vs. service agreement performance requirements and against external benchmarks</td>
</tr>
<tr>
<td>2. External manager uses its influence over the REIT to further its own interests over those of the REIT’s shareholders or bondholders</td>
<td>External manager holds significant equity position in the REIT</td>
</tr>
<tr>
<td>3. External management representation on boards limits board’s capacity to independently oversee external manager</td>
<td>Limited, if any, board representation for the external management; large contingent of independent directors; independent director is non-executive chairman</td>
</tr>
<tr>
<td>4. REIT senior executives (incl. the CEO) are appointed by external manager, not the REIT board</td>
<td>Explicit role for independent directors in the senior executive appointment process</td>
</tr>
<tr>
<td>5. REIT boards have limited influence over executive pay</td>
<td>Explicit, detailed performance conditions included in service contract, along with mechanisms that enable the REIT to push for improvements when standards not met.</td>
</tr>
<tr>
<td>6. Few, if any, independent control structures</td>
<td>Explicit role for audit committee in directing work of key control functions, particularly internal audit; limited, if any, role for internal audit in the audits of other external manager affiliates</td>
</tr>
</tbody>
</table>
### APPENDIX VII: Overview of Typical REIT Management Structures by Country/Region

*Source: Moody's*

<table>
<thead>
<tr>
<th>Region/country</th>
<th>Dominant Management Structure(s)</th>
<th>Trend in Management Structure</th>
<th>Comments on External Management Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Both internally and externally managed.</td>
<td>Large portion of REITs have transitioned to internal management structures over the last few years</td>
<td>So-called stapled security structure legally binds together units in the property trust (which owns the underlying property) and shares in the property management entity, which are traded as one unit. This structure acts as a takeover defense for property managers limiting the risk of other property managers acquiring their property assets.</td>
</tr>
<tr>
<td>Canada</td>
<td>Typically internally managed, with a few externally managed REITs</td>
<td>Continued transitions to internal management</td>
<td>Complex organizational structures. External managers may be related companies that hold an ownership stake in the REIT, are owned by owner-managers or are joint-ventures.</td>
</tr>
<tr>
<td>Europe</td>
<td>Typically internally managed</td>
<td></td>
<td>The majority of REITs across Europe are internally managed. Internal managers may sometimes be a parent or subsidiary of the property company.</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Typically internally managed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Externally managed</td>
<td></td>
<td>Control of REITs is entrusted to external managers and their directors. REIT directors have less ability to influence the management of the REIT. Risks lie in the potential conflicts of interest when external managers manage multiple REITs.</td>
</tr>
<tr>
<td>Singapore</td>
<td>Typically internally managed, with a few externally managed REITs</td>
<td></td>
<td>Can be complicated ownership and management structures, which include sponsors that support REITs and back management staff in REIT management. Managers can be separate entities that are subsidiaries of larger companies</td>
</tr>
<tr>
<td>U.S.</td>
<td>Typically internally managed, with a few externally managed REITs</td>
<td>Continued transitions to internal management</td>
<td>External managers are often controlled by owner-managers and may manage multiple and related REITs</td>
</tr>
</tbody>
</table>
APPENDIX VIII: Sampling of Taxable REIT Subsidiaries in the US

*Source: Real Estate Portfolio Magazine*

**American Investment & Management Co. (NYSE: AIV)**

Purpose: On average, AIMCO has used 155 entities a year from 2001 to present in order to provide asset management or financial management of properties as well as non-customary services to properties and tenants, such as food service, recording studios, health clubs and convenience stores. Additionally, AIMCO owns a company through a TRS entity that provides properties with customary property/hazard insurance as well as additional flood insurance for hurricane and tropical storms.

**Archstone-Smith (NYSE: ASN)**

Purpose: Archstone-Smith has used subsidiaries to leverage its core expertise in buying, developing and operating apartments, as well as to invest in commodity markets and create attractive return with shorter-term ownership.

**AvalonBay Communities, Inc. (NYSE: AVB)**

Purpose: Used on a limited basis to receive a commission from a "preferred provider" vendor used by residents.

**Colonial Properties Trust (NYSE: CLP)**

Purpose: Colonial Properties Services, Inc. (CPSI), has been used from 2001 to 2004 to accommodate sales from land out-parcels and management fee income, and this year CPSI has produced revenue from condo-conversions, build-to-suit contracts, and for-sale projects.

**Developers Diversified Realty Corporation (NYSE: DDR)**

Purpose: DDR uses TRS for redevelopments, specifically the CityPlace development in Long Beach, Calif., or with its Retail Value Investment Program LP III (RVIP), a joint venture with Prudential Real Estate Investors and Coventry Real Estate Partners for development.

**Equity Inns (NYSE: ENN)**

Purpose: Equity leases all of its hotels to its taxable REIT subsidiaries.

**Gramercy Capital Corp (NYSE: GKK)**

Purpose: TRS were used for the company's $1 billion pricing of commercial real estate collateralized debt obligation (CDO) in 2005. CDO Securities were issued by two Gramercy subsidiaries and consist of $810.5 million of investment grade notes, $84.5 million of non-investment grade notes and $105 million of preferred shares.
Hospitality Properties Trust (NYSE: HPT)
Purpose: As of June 30, 2005, HPT used TRS to lease and manage 189 of its hotels.

IMPAC Mortgage Holdings (NYSE: IMH)
Purpose: IMPAC’s subsidiaries, IMPAC Funding Corporation, IMPAC Warehouse Lending Group, IMPAC Multifamily Capital Corporation, and Novelle Financial Services, have been used since 1995 for nonconforming Alt-A mortgage loans, to originate small balance multifamily loans through brokers on a wholesale basis, to originate first and second mortgage programs and to assist in the development of creative subprime loan products.

Innkeepers USA Trust (NYSE: KPA)
Purpose: Innkeepers' TRS manage six extended-stay property hotels previously leased to Wyndham International.

Kimco Realty Corporation (NYSE: KIM)
Purpose: Since 2001, Kimco has used the TRS Kimco Realty Services Inc., for real estate brokerage, lending to retailers and property owners, debtor in possession financing, recapitalization of bankrupt retailers, designation rights agreements, common stock investments, non-qualified service activities and merchant building. Kimco Developers Inc, also developed in 2001, is used to provide partnership capital development expertise on leasing, construction and the approval process to developers and landowners to be built or redeveloped retail centers. Kimco provides advisory and support services to its properties through Kimsouth Realty Inc, a joint venture between Kimco and Prometheus Southeast Retail Trust, acquired in 2002.

Simon Property Group (NYSE: SPG)
Purpose: M.S. Management Associates, Inc. became a TRS of SPG in 2001. It provides management, leasing and other services.

SL Green Realty Corp. (NYSE: SLG)
Purpose: Established in 2000, eEmerge offers short-term work space solutions for companies needing ready-to-use office space.

Thornburg Mortgage (NYSE: TMA)
Purpose: Thornburg Mortgage formed Thornburg Mortgage Home Loans in May 2004. The TRS is used for loan origination, loan acquisition and loan securitizations. The subsidiary also presents the ability to diversify funding sources and permanently finance ARM loans through CDO issuance.

Winston Hotels Inc. (NYSE: WXH)
Purpose: Having formed Barclay Hospitality Services in 2002, Winston Hotels Inc. uses the subsidiary to lease hotels from the parent company.
APPENDIX IX: Macquarie’s ECLIPSE Analysis

Stage 1 – First Attempt
Listed Property companies are lowly geared, illiquid and are usually composed of a single asset. REITs are owned mostly by individual investors and do not have a competitive cost of capital.

Stage 2 - Legislative Change
Government recognizes the benefits of a healthy REIT market and brings in regulatory change to encourage REITs. These changes can provoke strong share price gains by property trusts. For example, the waiver of dividend taxes in Singapore spurred a new wave of enthusiasm for REITs.

Stage 3 - Acquisition Driven Growth
The market provides REITs with a cost of capital low enough to acquire buildings that are yield-accretive. Early REITs gain first mover advantage and have limited competition in the acquisition market relative to mature markets. Large earnings per share and dividends per share revisions are also possible in Stage 3. This stage ends when yield accretive acquisitions are difficult to find and REITs start looking to buy abroad. For example, Australian REITs started looking in the United States in the mid 1990’s.

Stage 4 – Growth Plateaus
As acquisition in local and foreign markets dry up. REITs will then focus on management efficiencies of their existing properties in areas such as leasing and property management, internal organization restructuring and more aggressive development will also be apparent. Using Australian REIT Gander as an example, by late 2005, it had a development pipeline of $1.1 billion from which it expected to earn an average yield of 8%. Its buildings were 99.9% occupied.
Stage 5 (Path 1 or Path 2)

Path 1 - Operational Earnings enter the Income statement
As acquisitions run out and management efficiencies are maximized, legislation makes changes to allow operating businesses, such as property development companies, to be “stapled” to the REIT. Similar to the Australian structure, a REIT shareholder would not only own units in the trust, but shares in the company as well. This structure allowed Australian REITs to be exposed to construction activity at a time when there was a glut in real estate supply and there was opportunity to develop. However, Macquarie believes that Asian REIT regulators might not go this road as they believe that development might add too much risk and speculation in a REIT’s activities.

Path 2 – Inertia
As Asian REIT Regulators prohibit development activities, they remain pure investments in rental income. REIT earnings become more susceptible to interest rates and rental yields in the physical property markets. They still provide consistent and stable sources of income but remain largely inert investment products.

Stage 6 – Consolidation
Legislation allows REIT managers start to pursue merger and acquisition strategies. In an effort to stop the lost income due to external management fees, REIT managers merge with the REIT. This move aligns the interest of the REIT managers and the shareholders. Underperforming REITs are also the target of takeovers of more effective REIT managers.

Sector 7 – Growth Plateaus Again
Lower growth and price gain in the REIT markets. Internal Management structures dominate the REIT landscape.
Macquarie ECLIPSE Model

The ability for operational earnings development, fund management earnings streams, etc, is largely dependent on the suitability of legislation currently not accommodated in Japan, Singapore, and Hong Kong.

Above average growth up path 1 becomes dominated by manager value-add strategies and operational earnings.

Interest rates and property cap rates become more critical in Path 2.

Stage 1  Stage 2  Stage 3  Stage 4  Stage 5  Stage 6  Stage 7  Stage 8
APPENDIX X: About CapitaLand
Source: CRCT Prospectus

The Sponsor, CapitaLand Limited, is one of the largest listed property companies in Asia. Headquartered in Singapore, the multinational company’s core businesses in property, hospitality and real estate financial services are focused in gateway cities in Asia Pacific, Europe and the Middle East. The Sponsor’s property and hospitality portfolio spans more than 70 cities in nearly 18 countries, with total assets exceeding S$18.7 billion as at 30 June 2006. The Sponsor also leverages on its significant real estate asset base and market knowledge to develop real estate financial products and services in Singapore and the region.

The Sponsor’s listed subsidiaries and associates include the following REITs — CMT (Singapore’s first REIT), CCT (Singapore’s first commercial REIT), and ART (Singapore’s first pan-Asian serviced residence REIT).

For the period ended 30 June 2006, the CapitaLand Group reported profit after tax and minority interests of S$288.7 million, a 35.2% increase compared to S$213.6 million in the period ended 30 June 2005.

The Sponsor, through its indirect wholly-owned subsidiary, CapitaLand China, is well established as a reputable real estate developer in China through its 12 years of operations in China and its proven track record. The Sponsor’s property portfolio in China spans more than 30 cities with a total project expenditure of over RMB30 billion. As at mid-2006, CapitaLand China has sold over 6,000 residential units, with more than 35,000 units in the pipeline. The residential developments include Oasis Riviera and Parc Tresor in Shanghai, La Foret in Beijing, Jinshazhou project in Guangzhou, Jiangbei project in Ningbo and Gongshu project in Hangzhou. CapitaLand China has completed approximately 270,000 sq m of commercial and integrated projects, including the flagship Raffles City Shanghai. There is currently approximately 390,000 sq m of commercial space in the pipeline including Raffles City Beijing and Capital Tower Beijing.

The Sponsor also has a joint venture with Pantaloon Retail (India) Ltd to manage close to 50 malls across 30 cities and 14 states across India.

CapitaLand Limited has extensive experience in creating, managing and investing in property funds and real estate financial products. It identifies attractive assets for injection into new property funds to meet the risk-return profiles of local and international investors. It has leveraged on opportunities within the asset base of the CapitaLand Group in the origination of, and investment in, several property funds, including:
• **CapitaMall Trust**
In 2002, CMT became the first REIT to be listed on the SGX-ST. It is managed by CMTML, which is an indirect wholly-owned subsidiary of the Sponsor. CMT owns ten quality shopping centers in Singapore and its investment strategy is to invest in real estate in Singapore which is income-producing and which is used, or substantially used, for retail purposes. The investment portfolio of CMT is S$4.3 billion and its market capitalization as at 31 August 2006 was approximately S$3.3 billion.

• **CapitaCommercial Trust**
CCT is Singapore’s first commercial REIT listed in May 2004. Its investment objective is to own and invest in real estate and real estate-related assets in Singapore and abroad which are income-producing and used, or predominantly used, for commercial purposes. CCT currently owns a S$3.6 billion portfolio of nine prime properties in the Singapore CBD and Downtown Core. CCT is managed by CapitaCommercial Trust Management Limited (“CCTML”), an indirect wholly-owned subsidiary of CapitaLand Group. The market capitalization of CCT as at 31 August 2006 was approximately S$1.8 billion.

• **Ascott Residence Trust**
ART, listed in March 2006, is the first Pan-Asian serviced residence REIT established with the objective of investing on a long term basis primarily in serviced residences real estate and related assets, which are income-producing. Its current asset portfolio comprises 14 serviced residences and rental housing property located in Singapore, China, Japan, Vietnam, Philippines and Indonesia. These properties are predominantly used as serviced residences or rental housing properties in the Pan-Asian region. ART is managed by Ascott Residence Trust Management Limited which is a direct wholly-owned subsidiary of The Ascott Group Limited, a leading international serviced residence company. The market capitalization of ART as at 31 August 2006 was S$517.7 million.

• **CapitaRetail Japan Fund Private Limited**
CapitaRetail Japan Fund Private Limited was established in 2004 by CapitaLand Financial Limited, a member of the CapitaLand Group, as a closed-end private fund to provide institutional investors with an opportunity to invest in retail investment properties in Japan. To date, CapitaRetail Japan Fund Private Limited has acquired five properties in Japan with a portfolio value of approximately Yen 43.3 billion (La Park Mizue in Tokyo, Izumiya Hirakata in Osaka, Vivit Square in Tokyo and Ito Yokado Chitose and Ito Yokado Eniwa in Hokkaido).

• **CapitaRetail Singapore Limited**
CapitaRetail Singapore Limited was established in 2004 by CapitaLand Retail Limited as a special purpose vehicle to issue EUR81.0 million and S$329.0 million in principal amounts of bonds secured on three retail malls in Singapore (Bukit Panjang Plaza, Lot One Shoppers’ Mall
and Rivervale Mall) held by CapitaRetail Singapore Limited through separate single purpose trusts.

• **CapitaLand China Development Fund Pte. Ltd.**
The US$400.0 million fund was closed in October 2005. The fund is sponsored by the Sponsor and co-marketed by Citigroup to invest in development projects in China. The fund will focus on residential, office, mixed and serviced apartment developments in the high density growth centers namely in the Bohai Gulf Region, Yangtze River Delta, Western/Central China and Pearl River Delta.

• **CapitaLand China Residential Fund Ltd.**
The US$61.0 million fund was launched in October 2003 to invest in mid to high-end residential development projects in Shanghai, Beijing and Guangzhou to capitalize on the growth of the residential property market in China.

• **CapitaRetail China Development Fund**
The Development Fund invests primarily in the development of retail malls in various cities of China. The Sponsor has, through its strategic alliance with SZITIC (a Chinese state-owned trust and investment firm) secured a pipeline of development projects for the Development Fund. The pipeline comprises mainly retail mall developments in China undertaken or to be undertaken by the SZITIC Group. The Development Fund may also invest in retail mall developments in China with third parties.

The Development Fund has the financial strength, retail development and management expertise to acquire land in China for development into successful retail malls that can be offered to CRCT for acquisition. The Development Fund was formed on 6 June 2006, with a total committed capital from its investors of US$600.0 million, which would allow a maximum total asset size of approximately US$1.5 billion.

• **CapitaRetail China Incubator Fund**
The Incubator Fund invests in retail malls in China with good long-term potential to generate quality income after repositioning, asset enhancement initiatives or leasing activities to increase occupancy rates. The Incubator Fund will be able to offer these malls to CRCT for acquisition when they meet CRCT’s investment criteria and targeted returns after such repositioning, asset enhancement initiatives or leasing activities. The Sponsor has, through its strategic alliance with Beijing Hualian, secured a pipeline of retail malls in China for acquisition by the Incubator Fund. The pipeline consists of retail malls in China that are owned or to be owned by the Beijing Hualian Group. The Incubator Fund may also invest in retail malls in China with third parties. The Incubator Fund was formed on 6 June 2006 and has a total committed capital of US$425.0 million from its investors, which allows a maximum total asset size of approximately US$1.1 billion.