CHAPTER IV

GLOBAL COMPARABILITY OF REITs IN INDIA AND DEVELOPER’S PERCEPTION

4.1 Introduction

We discussed about the developments of REITs using SWOT (strengths, weaknesses, opportunities, and threats) analysis, the most recent development of REITs markets in Asia, and the study of the major internal and external factors/issues affecting Asian as well as Indian REITs. The framework of SWOT analysis is one of the most effective tools to assess the strategic situation for a market, and most importantly, provide a systematic understanding of the Indian REITs market in both the short and long term. While Indian REITs market is prosperous from both supply and demand side, there are more room for its further growth and more can be done to reduce the hurdles. The analysis also emphasizes that REITs investors should not pursue extreme speculations on Indian REITs.

4.2 Global REITs – Development and Outlook

REITs have been discussed from a global perspective, including the US, Asia and Europe. The Global Real Estate Investment Trust, or REITs, market has grown exponentially over the past few years. More and more countries have embraced a tax efficient property listing structure to encourage private commercial property investment. There have been several key factors driving this growth. Global investors have become increasingly disillusioned by poorly performing equity markets and have been eager to access investments offering lower risks and steadier returns. The world's major economies have also experienced lower investment returns in a generally low inflation and low interest rate environment. Investors are also slowly becoming aware of the growing need to save for longer and increasingly underfunded retirement periods. More and more countries are discovering the benefits of REITs. They offer tax transparency, liquidity, improved corporate structures, simpler tax structures, easier access to all forms of capital including unsecured debt, and greater overall property market efficiency, and are altering their laws to create REITs-like vehicles to realize these benefits. However, the main disadvantage is that one of the key benefits
of owning direct property that of lower volatility is reduced through the use of a
directly listed vehicle such as REITs. The US and Australian markets are used for
comparison purposes, as these markets are the most mature of the global real estate
markets and provide the best comparison of how the potential UK tax efficient regime
will look. Though direct property exhibits lower risk than the listed markets, the
REITs sectors in the US and Australia infer that higher returns can be achieved for
investors by sacrificing some of this lower risk. Another compensating factor, and
indeed the crux of these tax-efficient investment vehicles, is the increased liquidity
and lower transaction costs that they offer investors. One of the key advantages of
REITs structures has been observed in markets where REITs systems have been
introduced, where discounts to Net Asset Value (NAV) have reduced substantially,
removing the tax overhang from share valuations. Markets such as France have seen
the average discount to NAV decrease from around 30% in early 2003, to a current
aggregate sector premium of almost 10% since the tax efficient SIIC structure was
introduced. In comparison, although the UK real estate sector has seen discounts
narrow from around 40% in early 2003 to around 15% in anticipation of a similar
structure, discounts to NAV still exist reflecting a tax disadvantage overhang on share
valuations. This reduction in NAV discounts, coupled with strong aggregate
performance of the underlying property markets in most countries since the early
1990's, has driven comparatively strong REITs performance globally. One of the key
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overhang on share valuations. This reduction in NAV discounts, coupled with strong
aggregate performance of the underlying property markets in most countries since the
early 1990’s, has driven comparatively strong REITs performance globally. The
EPRA/NAREITS Global Index includes the main constituent real estate stocks listed
across the world and currently has a market capitalization of some US$460Bn.
However, the index does not include all listed stocks and is calculated on a 'free-float',
or investible total basis, so care must be taken when comparing it to full market capitalization totals used elsewhere. The largest markets that currently enjoy a tax transparent commercial property investment vehicle are the USA and Australia, followed by a plethora of smaller REITs markets. Recent years have seen Japan, France, Singapore, Korea and Hong Kong join the REITs bandwagon, while the UK, Germany, Italy, Taiwan and even Mexico appear likely to be next to join the revolution. Various other countries, especially in Asia, have also intimated their willingness to consider a similar structure. Congress created the US REITs asset class in 1960 to facilitate public access to the large-scale commercial property market. The diversification benefits due to lower correlation with other asset classes coupled with strong relative outperformance over most time periods conspire to push REITs up the desirable investment scale. Other countries, which are officially looking at introducing similar tax efficient systems in the near future, include the UK and Germany. UBS Warburg expect that following the recent well publicized scandals in Germany, there is now a 50%-70% chance that a German REITs will be established in the next few years. Mexico has recently introduced the LISR law, which extends tax benefits to trusts whose sole purpose is to purchase and/or manage real estate. The law now just needs to be extended to offer guidance on how these trusts can be structured and the rules for distributions, etc. The outlook for global REITs markets in general looks very positive, as retail demand shows no signs of slowing down. Most underlying direct property market fundamentals appear intact and while a general global slowdown in property returns in widely expected, strong positive returns should still be achievable in most markets. The UK and Germany appear to be the most likely markets to launch the next REITs type vehicles, while other countries are sure to be close behind. The potential for growth in REITs worldwide is summarized in the table below which shows that both Asia ex-Australia and Europe have the largest potential to grow.
Table 17 Countries and percentage underlying real estate in REITs

<table>
<thead>
<tr>
<th>Country</th>
<th>World underlying real estate %</th>
<th>Underlying Real estate (US$bn)</th>
<th>Listed real Estate US % Bn (total assets)</th>
<th>Listed Real Estate US % Bn</th>
<th>% listed Real estate</th>
<th>% stock market</th>
<th>% Underlying Real estate</th>
<th>% underlying real estate in REITs</th>
</tr>
</thead>
<tbody>
<tr>
<td>United states</td>
<td>43</td>
<td>2525</td>
<td>295</td>
<td>295</td>
<td>49</td>
<td>1</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Continental Europe</td>
<td>26</td>
<td>2500</td>
<td>50</td>
<td>38</td>
<td>8</td>
<td>1</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Japan</td>
<td>12</td>
<td>705</td>
<td>58</td>
<td>16</td>
<td>10</td>
<td>2</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>HK/China</td>
<td>9</td>
<td>540</td>
<td>68</td>
<td>0</td>
<td>11</td>
<td>7</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>UK</td>
<td>8</td>
<td>490</td>
<td>80</td>
<td>0</td>
<td>13</td>
<td>2</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td>Australia</td>
<td>2</td>
<td>100</td>
<td>45</td>
<td>50</td>
<td>9</td>
<td>9</td>
<td>45</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>5860</td>
<td>596</td>
<td>399</td>
<td>100</td>
<td>3</td>
<td>10</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: National Association of Real Investment Trust, USA

This report has covered listed REITs with a total market capitalization, worldwide, of USD608 billion (AUD819.5 billion). After taking into account the effect of gearing, this represents in excess of USD 890.9 billion (AUD1.2 trillion) in property assets within the Global REITs sector. This figure, more than any other, emphasizes the significant presence that REITs have, and their role in the global economy.
4.3 Countries and regions

Table 18 Global Region

<table>
<thead>
<tr>
<th>Global region</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>United states, Canada</td>
</tr>
<tr>
<td>Europe, middle east and Africa (EMEA)</td>
<td>France, Belgium, Netherlands, South Africa</td>
</tr>
<tr>
<td>Pacific</td>
<td>Australia, New Zealand</td>
</tr>
<tr>
<td>Asia</td>
<td>Hong Kong, Japan, Malaysia, Singapore, South Korea, Taiwan</td>
</tr>
</tbody>
</table>

Source: National Association of Real Investment Trust, USA

Throughout the thesis we analyze results in terms of the thirteen countries, as well as the four regions. The following charts graphically present the population (figure 28), by number of REITs, in each of the regions and countries: The above charts include a total population of individual REITs reviewed within this report of 484 individual entities, as at 30 June 2006. While 253 of these are in the United States, the presence of REITs all around the world is now also significant. Having reviewed in detail the stage of development of REITs in all relevant countries throughout the world, we have selected thirteen separate countries for review in this Global REITs Report. There are other newer REITs markets, particularly in Asia and Europe that will be included in future years as they become more established. However, for the Global REITs, the following countries have been included. Three key elements are of essential importance in the structure of REITs. They are: Underlying assets and most of the income of REITs are closely restricted to real estate, plus a limited portfolio of securities; REITs’ units traded on stock market like normal share, but exempt from taxation at corporate level, such as enjoy the benefits of tax transparency; The compulsory distribution of most earnings was consistent with the idea that REITs are passive wealth management instruments (Campbell and Sirmans, 2002). Exception of the above three essential elements, which are fundamental to the definition of all REITs, there are some other limitations on REITs structure, financing, operation issues. These restrictive issues aimed to reduce unfair competition with other taxable entities. In reality, they varied in response to the different region/market and the
changing business environment (Campbell and Sirmans, 2002). The most two matured REITs markets in the world - REITs in US and LPTs in Australia, adopted this concept and debuted their REITs in 1960 and 1971, respectively. Since then, REITs family underwent significant evolution over the past four decades. With their success and impressive growth in recent 10 years, REITs markets have grown bigger and matured. Nowadays, the development of REITs worldwide appears with two key characteristics:

1) REITs in US and LPTs in Australia getting bigger & mature, and expanding internationally;

2) The proliferation of REITs markets continuing, with steady developed in Europe and rapid growth in Asia.

In Asia, as the first REITs developed in Japan, 2001, the rapid development of EIT market has been compelling. Figure 27 shows the evolution of the Asian REITs market capitalization in the past four years, and Figure 28 below presents the current composition of Asian REITs market.

**Figure 27 Evolution of Asian REITs market capitalizations (at Oct. 2005)**

![Graph showing the evolution of Asian REITs market capitalizations]

Source: UBS investment Bank, DataStream at 21 Oct 2005
Figure 28 Current composition of Asian REITs market (at Oct. 2005)

Source: Bloomberg, Credit Suisse First Boston

Table 19 Regimes and number of REITs

<table>
<thead>
<tr>
<th>Regimes</th>
<th>No. of REITs</th>
<th>Market cap. US$ bn</th>
<th>% of total cap.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>23</td>
<td>22.1</td>
<td>73%</td>
</tr>
<tr>
<td>Singapore</td>
<td>7</td>
<td>6.5</td>
<td>21%</td>
</tr>
<tr>
<td>Korea</td>
<td>7</td>
<td>0.6</td>
<td>2%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4</td>
<td>0.2</td>
<td>1%</td>
</tr>
<tr>
<td>Thailand</td>
<td>8</td>
<td>0.5</td>
<td>2%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1</td>
<td>0.2</td>
<td>1%</td>
</tr>
<tr>
<td>Total</td>
<td>50</td>
<td>30.1</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Bloomberg, Credit Suisse First Boston

Overall, current Asian REITs are experiencing fast growth in its initial stage. As each country has a different set of real estate market conditions, economic environment and variety of tax, accounting and government regulatory policies relating to real estate investment, the success of REITs in Asia would depend on how Asian REITs market evolves with the changing internal and external economy environment. Therefore, timely research on these changing factors is an important task for REITs industrial participants.
4.4 Major Aspects Affecting the Current Asian and Indian REITs

Many factors may influence the success and efficiency of the developing REITs markets in India.

Based on the current situation of Indian REITs, and combining the experiences of mature REITs markets in US & Australia, we construct six major aspects as the criteria for analysis. Although, many identify affecting factors involved in each aspect, we will pick up some representative issues to analyze, presenting an overview of the current developing Indian REITs market by using the SWOT analysis framework (see Figure 29).

**Figure 29 Major factors affecting Indian REITs**

![Diagram of major factors affecting Indian REITs]

**Source:** Researcher’s compilation based on the literature.
4.4.1 Government

Government from legislative aspect has always acted a crucial role in creating and developing a REITs market, even the possible market trends in the future. As the Asian REITs at his early age of growing, it is absolutely necessary to have strong legislative framework that allows and supports the development of REITs. This includes favorable regulations with fewer restrictions on real estate investment, taxation and gearing. Specific designed incentives such as exemption from property related taxes and fees would also help the growth of this industry. Otherwise, legislative restrictions will limit and obstruct the development of REITs. It can be easily evidenced from the evolution of REITs in US and Australia, and the short history of Asian REITs market as well.

4.4.2 Investor

The demand of REITs was sourced from investor’s interest in this sector. No matters of individual or institution, investors consider the return and risk profile as key issue while choosing investment instrument. A huge trend in current investors is looking for safe investments based on the following two facts: 1. the aging population and high savings rate keep high in India. 2. The portion of extreme speculation decreased after Indian financial crisis. The high distributions and stable capitalization growth characteristics provided by REITs just match the common investor’s requirement.

4.4.3 Finance

As an investment instrument related to specific asset of real estate, REITs provides real estate (property) market with great financing opportunities, while supplying the capital (stock) market with a less-correlated asset class to diversify the portfolio in their investment. Also, as REITs are listed and traded on stock market, therefore, financial environment affect the performance of the REITs markets directly.

4.4.4 Real estate

Most value of REITs was on the value of underlying asset (real estate). For REITs was obligated to focus on real estate asset and its rental as major income resource, the change of real estate market will fundamentally vary the value of the REITs.
4.4.5 Regional

Regionally characteristics within Asia are classified as internal factors for REITs industry. Some positive factors such as overall economic and real estate market recovering in Asia and moderate competition of REITs hub between Hong Kong & Singapore governments, promote the growth of REITs in Asia. While some negative factors like immature local market system and potentially over speculation in real estate normally being the weakness and threats of the market.

4.4.6 Global

As this analysis concentrates on the Asian REITs market, external factors from global aspect come from matured REITs market in US and Australia currently.

4.5 SWOT Analysis of Recent Asian REITs Market

SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis is one of the most effective tools to assess the strategic situation for a specific market. Strength is internal resource that the organization can use effectively to achieve its objectives. Weakness is a limitation, drawback, or defect in the organization that will keep it from achieving its objective or limited of its growth. An opportunity is any favorable situation in the related environment. And a threat is any unfavorable situation in the related environment that is potentially damaging to its strategy (Rowe, 1994).

4.6 Strength: According to the major aspects stated above, the main strengths of current developing Asian REITs are listed as follows:

4.6.1 Strong Demand and Supply

On the demand-side: REITs generally provide high dividend, low volatility and diversification benefits in investment portfolio, investors’ thirty for yield has been and remains the biggest demand driver. Comparison with other product, in many investors’ view, stocks are too risky while bonds have less attraction with returns. The return and risk profile of REITs just filling the position. In addition, the considerable low correlation with shares and bonds, REITs product also show extremely competitive in portfolio risk diversification. REITs products with these characteristics were warmly welcomed by both institutional and individual investors in Asia. The
increasingly institutional investors, such as pension funds and insurance companies put REITs into their investment portfolio. As the aging society approaching in Asian and other countries, the related growing pension liability is expected to add further demand to REITs in Asia. From the supply-side: The driving forces for REITs came mainly from the following three related groups: financial institutions, real estate owners or developers, and some government departments who in charge of social real estate assets. Using REITs, these groups activate the capital which was locked in these assets via transferred their ownership. Commercial banks in Asia, always keep the risks in the balance sheet for their real estate borrowers. Especially after Asian financial crisis in 1990’s, many banks burdened with amount of non-performing loans, are longing for the route to exit the situation. REITs just satisfied this huge demand. Many real estate companies in Asia act as major developers and part of property owners as well. From one hand, REITs provides a alternative sources of funding for development business other than heavily depend on bank financing; on the other hand, divestment of these asset ownership to public make the capital of the asset to be recycled - redployed to other investment or business. This also generate an opportunity to company who want adopt an asset light strategy in their business structure. REITs also open a door for government to divest the social assets to public ownership. The new listed, biggest in the world, LINK REITs in Hong Kong, is the representative, which comprises much of prior government assets. After transferring into REITs, these assets were owned publicly, managed by professional asset manager. In one words, REITs paved a relative broad way to almost all major real estate participants to upgrade their financial situation, create financial support opportunity by transferring the ownership. And this function in practice, has been accepted widely in Asian as well as Indian market, which reflected by the current strong demand and supply situation. According to a research report by UBS, it was said that “the consequence of introduction of REITs in Asia, create the opportunity to increasingly invest in real estate via a listed form which is able to efficiently capture underlying real estate returns (through REITs)”, “Furthermore, given the positive supply dynamics (via increased securitization and REITs) and demand dynamics (ongoing allocations from an under – allocated aging demographic) of listed real estate, the medium-term outlook remains positive. (Crowe, S.et al, 2005).


**Government Incentives**

Government incentives to establish and promote REITs market may be the most important impacting factors, at least in the current infancy stage of Asian REITs. Government incentives to introduction of REITs largely rooted from their motivations, the following summary (Table 20) reviews and compared their original intentions.

**Table 20 Summary of motivations of established REITs regimes in Asia**

<table>
<thead>
<tr>
<th>Countries</th>
<th>Motivations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>as part of restructuring the economy and real estate market, started with bad-quality assets for both and financial institutions to dispose of the Non-performing assets (Kitsuda, 2003).</td>
</tr>
<tr>
<td>Singapore</td>
<td>changing business strategy to grow fund management income; seeking property development opportunities in other Asian countries; Transferring ownership to public via REITs</td>
</tr>
<tr>
<td>Korea &amp; Taiwan</td>
<td>help financial institutions and government asset management companies to divest non-core investment.</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>divest real estate as it focus more on development, divest government asset by transferring ownership to public.</td>
</tr>
</tbody>
</table>

**Source:** Author’s compilations based on various publications.

To some extent, varied motivations reflect how local government understand the REITs for their domestic finance and real estate markets; however, the rapid growth of Asian REITs were directly benefit from government incentives imposed through REITs legislations. This applies in Singapore as well, where the government was considered as most proactive and progressive in the region in promoting the REITs industry.
Figure 30 Relationship between Singapore REITs index and government incentives

![Graph showing the relationship between Singapore REITs index and government incentives from July 2002 to July 2005.]

Source: MAS, IRAS, CPF, Bloomberg

Figure 30 shows six events that have improved the S-REITs market through government incentives, and the events were described as follows:

1) CPF Board announced on 29 August 2002 that property funds (or REITs) would be included under the CPFIS-OA.

2) MAS issued revised guidelines on 28 March 2003 to raise gearing limit for S-REITs from 25% to 35%.

3) Resident and non-resident individuals would be exempted from tax on certain investment incomes, including distributions from S-REITs to which unit holders are entitled on or after 1 Jan 04.

4) From 28 February 2005, the following changes applied: a) 3% stamp duty waived and tax rate on distributions to foreign non-individual investors reduced from 20% to 10% for the next five years; b) to qualify for tax transparency, S-REITs trustees no longer need to furnish letter of indemnity to CIT and derive 100% income from property and related assets, as long as they distribute at least 90% of taxable income, c) S-REITs that invest in foreign properties may apply to the MOF for tax exemption on certain foreign income.
5) MAS released a consultation paper on 10 June 2005 to propose enhancements to the regulations of S-REITs, including improving the corporate governance practices, allowing REITs to engage in property development (subject to a 10% cap), and allowing borrowings in excess of 35% but not to exceed 60%.

6) MAS revised the guidelines on REITs on 20 October 2005 to effect key changes that included: improving corporate governance, facilitating overseas acquisitions and partial ownership of properties, allowing the total of borrowing and deferred payments to exceed 35% (subject to a 60% cap) provided credit rating is obtained from a major rating agency and disclosed (Fong, E. et al, 2005). Reviewing the government incentives in the case of Singapore REITs, it is clearly demonstrated that government incentives directly support the growth of S-REITs and market response is prompt. Singapore government, apparently, played an important role in forming a successful environment for their local REITs market. Expanding the experience to other Asian countries, favorable regulatory as catalyst is one of necessary conditions for Asian REITs. Moreover, as Singapore and Hong Kong government are competing to be the hub role in regional REITs market, it is reasonable to believe that more government incentives on issues of tax, gearing, and overseas investment, will spur the growth of local REITs market and channel the across-boarder listing for undeveloped REITs market, e.g. China and India.

**Exceptional Returns**

Strong demand and supply composite the huge dynamic push Asian REITs market out performance. The returns generated by Asian REITs to date have been extraordinarily high and attractive. As per the established REITs track record in Japan and Singapore, Asian REITs have generated double-digit returns annually. Moreover, its low level of volatility means that the less risk profile can be more attractive than other equities in capital market. Figure 31 shows the price performance (excluding dividend return) of the TOPIX REITs index and two longest running REITs (Capita Mall Trust & Ascend as REITs) over the last two years. On an annual basis, Japanese REITs obtained 19% in capital growth while the average market price of Capita Mall and Ascend as rose by 42%, 62% respectively per year (Reilly, 2005a).
As REITs in Singapore and Japan (together occupy over 95% of total Asian REITs capitalization) have delivered superior total returns in the past three years, it is one of the key attractive that kept the sustainable increase in demand for REITs products.

4.7 Weakness

Although REITs were warmly welcomed by investors, asset owners and regulators within financial and property industries in several Asian countries, as a diversified region, the overall economic strength and real estate market in Asia is immature. And Asian governments face a series of important decision regarding the features of Asian REITs, different regulatory still have a great impact on the development of REITs. Therefore, there is still a long way to go to establish a mature, wide spread Asian REITs markets.

**Immature Real Estate Market**

Rooted from real estate industry, the REITs industry cannot develop without its contribution. In other words, the immature industrial background will potentially limit the Asian REITs further growing. In the aspect of real estate market information transparency, according to the JLL global property transparency index (Jones Lang LaSalle, 2004), Asian property markets range globally from Transparent (Hong Kong: 7th and Singapore: 9th) to Semi-Transparent (Japan: 26th, Taiwan: 27th and Korea: 34th) and quite low transparency level (P. R. China: 39th, India: 41th and Vietnam: 47th), among 51 countries surveyed. Although a couple of countries show little
improvement, the overall Asian property industry remains diversified and has relatively low transparency. On the other hand, the most mature REITs market in US and Australia were both ranked at the top in the index. The fact in Asia is that some leading countries like Japan, Singapore, Korea and Hong Kong have established REITs on their relative better market system, it is still too early to expect that REITs will be widespread in whole Asia. Chris Reilly reported with his view of recent Asian REITs, “unfortunately, Asia (the fastest growing and most populous region in the world) has not been represented on the global property stage, and cross-border difference and poor transparency market appear to be a riskier investment prospect than Europe or the US” (Reilly, 2005b).

**Imperfect Legislative System**

Taking lessons from US and Australian experiences, to establish a successful REITs market, there must be a strong legislative framework that allows and supports the development of REITs. As other REITs leaders experienced before, most Asian governments is in a dilemma to how and when to liberalize the market. The creation of new REITs regimes within the region is finally subject to the resolution of regulatory issues. It is expected that REITs regulators in Asia offer more attractive tax incentives, encouraging the legislations to attract cross-border REITs activities and promoting local REITs listings. Korea and Hong Kong have created REITs for a couple of years, however, the development of REITs in both countries have lagged Japan and Singapore, largely because of their more restrictive REITs structures. In Korea, two types of REITs were introduced, General REITs (K-REITs) and Corporation Restructuring REITs (CR-REITs). Because there are too much legislative restrictions to K-REITs, such as limitation on gearing, minimum capitalization requirements, and no enjoying any tax benefits, up to now, K-REITs have not been launched yet (Conner, Liang, 2005). While some other restrictions for CR-REITs, there are seven CR-REITs with only US$0.6bn in capitalization. Similarly, in Hong Kong, before June 2005, Hong Kong REITs was restricted overseas investment; and gearing ratio was limited under 30% of gross asset value. Under so many restrictions, plus no tax benefits incentive, at least till now, Hong Kong REITs industry developed slowly, far behind its counterpart – Singapore,. It is lucky that most governments in Asia have noticed this problem, and are making the amendment on these restrictions.
In Korea, new REITs legislation offer K-REITs has same tax benefits as CR-REITs, borrowing and initial capitalization restrictions were relaxed. And in Hong Kong, the recent lifting of restriction issues on overseas investment and gearing ratio is regarded to step to the right direction, and these reforms have triggered several REITs which are in the pipeline for listing on Hong Kong Stock Exchange. Among them, GZI REITs is underlying 4-5 commercial properties in Mainland China. (Tan, 2005) However, although a number of Asian countries have introduced and reviewed new regulatory framework for REITs recently, there are more can be done to reduce hurdles. In Thailand, gearing has not been permitted until now. This makes Thailand less attractive than others in the region do. However, Thailand government is considering allowing a certain level of leverage. If this issue were amended, it would provide potential upside to REITs unit holders and create more interest to investors. Malaysia draws a lesson from its previous experience, the new REITs guidelines finally issued in January 2005, which liberalized borrowing limits, relaxed rules on acquisitions of leasehold properties, and allowed more opportunities on non-real estate assets. However, the payout issue will be addressed later, because no mandatory payout ratio required, will not guarantee the high payout ratio, which is contrary to the objective of making the REITs an income-oriented vehicle. Even in Singapore, considered as one of the most proactive in promoting the S-REITs industry, there remain a few regulatory issues that need to be improved. A most recent consultant paper proposed a number of changes to enhance the REITs regulations. These include licensing managers of Singapore REITs; more disclosure of transaction-based acquisition and disposal fees imposed by REITs managers; permit to engage in the development of properties that they intend to hold after completion (subject to a cap of 10% of total portfolio value); and give REITs more flexibility in determining their debt ratios by increasing the maximum borrowing limit to 60% of a REITs deposited property (real estate portfolio, 2005). Apparently, Singapore government has always and still active to ease restrictions, endeavor to establishing a better legislative system for S-REITs market, aim to promote the country as a world class financial centre in long-term.

4.8 Opportunities

The key opportunity for Asian REITs is that the total capitalization of Asian REITs is still quite small, comparing to mature REITs market in US and Australia, the nascent
Asian REITs market still have room for further growth. So far, despite Asian REITs grown rapidly in recent years, the ownership of investment grade properties by REITs in Asia is estimated to be quite small, compared to about 18% for US, 50% for Australia (Fullerton, 2005). Australia enjoys the highest percentage position in investment grade property by capitalization, which means half of investment grade property asset was securitized by REITs form, while most of Asian countries are fewer than 5%. As REITs generally focus on investment grade property, it indicates that much of quality property asset has not been involved into REITs structure in Asia.

Real estate assets held in private companies are typically less efficient in terms of management and taxes. As the property market continues to evolve, the trend will be that ownership shifting from the private to the public sector, i.e. REITs. It is estimated that total market capitalization of listed real estate company in Asia is over US$230bn. As REITs were accepted by private company owner as a favorable vehicle to reach their strategy goal at corporation level (1. unlock real estate capital and turn into higher return opportunities; 2. transfer the private ownership to public while adopt asset light strategy; 3. creation of REITs funds management platform ensures fee based income.), the trend of transferring ownership via REITs form will open a greater space for Asian REITs to grow. Especially in Hong Kong, REITs will catch much attention from the owners of listed property company. Other research institutions put forward the same viewpoint as well. An investment research report by UBS said, “In Japan, REITs market growth has brought over seven-fold increase, total market capitalization reach around US$25bn within only four years”. Although, it grows so fast when comparing to US and Australian REITs market (to reach the same size of capitalization, US takes 30 years and Australia takes 28 years), it only represents 0.5% of Japan’s GDP. Consider that the US REITs market is equivalent to about 3% of US GDP and that the Australian LPT market is equivalent to about 10% of Australian GDP, it would seem that the J-REITs market has the potential to grow to five or even 10 times of its current size. (Crowe et al, 2005). As for Singapore, researched by JP Morgan, 7 S-REITs only own an estimated 5% of the country’s net leasable office space, 10% of retail space and 3% of industrial space (Lau and Chu, 2005). However, as each five listed S-REITs occupying a specific sector with out-performance; more REITs in pipeline to listed, overseas asset were included, and
more M&A activities involved, present S-REITs are regarded stepping into a new phase of development (Sung, et al, 2005). As such, enhanced by considering the further improvement of real estate market in China and India, we believe there will be a significant scope for the nascent Asian REITs industry to continue to grow.

4.9 Threats

It is worth noting that REITs is a designed income-oriented investment vehicle for investors. The key threat come into mind is that REITs should not fuel speculation during the development of Asian REITs, because, the fundamental performance characteristics of the underlying asset are stable, attractive yield, modest asset appreciation and low correlations for diversified portfolio(Corner, Liang, 2005). Real estate investment has traditionally been a key investment in Asia, the strong propensity to invest real estate make the potential abused high historically. Compared to the current status of REITs in Europe and the evolution of REITs in US, recent amazing development in Asia, to some extent, reflect that potential force existed in the region. It was broadly acknowledged that US and Australia introduced REITs after its real estate industry had accumulated decades of experience, but much of Asia real estate market is relatively new. “Asia is more speculative than US and therefore more volatile” said by Pietro Doran, senior real estate advisor at Kearney Global in Seoul (Larkin, 2001). The lack of property market expertise and investment grade property asset will not change in short time. Investors’ blindly rush to invest in REITs sector might kill the industry. REITs sector in Asia is still relatively small and sensitive to the changing economic environment, therefore, all REITs governor keep the guidelines on REITs market to avoid it becoming an extreme speculative tool. And also, some strict measures were proposed to check the trend of speculation, such as REITs stock index. Overall, gaining the lessons from the financial crisis and speculative property markets in the late of 1990s, Asian REITs should be restricted to non-speculative instruments, and related regulators should guard against the speculation trend, and keep the Asian REITs to build dividends and diversification - as the logo of NAREITs telling us (NAREITs website).

4.10 PEST Factors

4.10.1 Political Factors

The Government has greatly influenced real estate development through various laws,
taxes, infrastructure and environmental regulations. The Construction Industry is considered to be one of the heavily taxed sectors of the economy. Any further tax imposed on this sector would affect the orderly growth and development of the Real Estate Sector.

4.10.2 Economic Factors

Macroeconomic factors according to me, which are instrumental in increasing real estate demand, are inflation levels and interest rates. Low and controlled inflation in the recent years have increased the purchasing power of consumers thereby increasing the demand for real estate. On the other hand, the banking sector has provided further liquidity into the domestic real estate market by charging lower interest rates. This has changed the lifestyle of consumers who now have easy access to credit facilities.

4.10.3 Socio-cultural Factors

There has been a rising trend in the per capita income and the Gross Domestic Product (GDP) of the Nation. The average salary of Indians is increasing every year with more Multi-National Companies coming into India. Urbanization is moving at a fast pace putting constant pressure on need for more urban land space. The inflation levels and interest rates being under control have led to higher disposable income and hence demand for more homes.

4.10.4 Technological Factors

The Internet revolution seems to be the most important technological innovation to impact real estate since the invention of the automobile and the elevator. Investors must keep the above factors influencing the Indian real estate scenario in mind before committing their wealth to this sector. The second finding disclosed that there are numerous avenues for investment in the Indian real estate market. With the real estate development of the REITs (Real Estate Investment Trusts) and REMF (Real Estate Mutual Fund) markets round the world over the past decade; India has plentiful opportunities coming its way once the REITs structure is established in India. The third finding revealed that infrastructure in India was a key problem faced by the sector. However recent years have witnessed active participation by the Government in the development of the sector, which has prevented dampening of investor spirit.
The fourth finding that came forth from the survey was foreign investments being a major source of capital for real estate development companies. This is probably the only striking difference from that of the literature review that strongly supports the role of the bank in providing the necessary finance to developers and its high correlation with the Indian real estate sector. This can be attributed to the recent change in RBI’s (Reserve Bank of India) policy disallowing loans for land acquisition purpose to keep a tight control on inflationary measures. Nonetheless; though banks have disallowed loans for land acquisition purposes, developers have not felt the restriction of funds due to the widening of India’s capital markets and access to foreign fund inflow. Overall, it is quite apparent from the research that if the real estate market is tapped and penetrated correctly; it has an outstanding future due to the sudden and consistent demand for property in the market for usage and investment purposes.

4.11 Developer’s Perception on REITs (Primary Data Analysis)

As per the responses of developers the following data has been analyzed for the Indian REITs. By analyzing the data of (table 21), it has been found that from the developers point of view Europe and north America has (45% and 40% respectively) developed in REITs. The third largest region is Asia (35%) followed by Middle East Africa (10%) and pacific (10%).

Table 21 Preference of Investment in Different Region

<table>
<thead>
<tr>
<th>Regions</th>
<th>least important</th>
<th>Less imps.</th>
<th>Important</th>
<th>More imps.</th>
<th>Most imps.</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>5</td>
<td>5</td>
<td>20</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Europe</td>
<td>5</td>
<td>10</td>
<td>20</td>
<td>20</td>
<td>45</td>
</tr>
<tr>
<td>Middle East Africa</td>
<td>35</td>
<td>25</td>
<td>20</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Pacific</td>
<td>25</td>
<td>30</td>
<td>25</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Asia</td>
<td>10</td>
<td>15</td>
<td>15</td>
<td>25</td>
<td>35</td>
</tr>
</tbody>
</table>
Table 22 Different Asset Class and their Importance for Financing the Projects

<table>
<thead>
<tr>
<th></th>
<th>least secure</th>
<th>less secure</th>
<th>secure</th>
<th>more secure</th>
<th>most secure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>Equity</td>
<td>5</td>
<td>5</td>
<td>10</td>
<td>35</td>
<td>45</td>
</tr>
<tr>
<td>REITs</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>Pre- launch</td>
<td>20</td>
<td>20</td>
<td>15</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>FDI/FII</td>
<td>15</td>
<td>15</td>
<td>25</td>
<td>25</td>
<td>20</td>
</tr>
</tbody>
</table>

From (table 22), it has been found that as far as asset class and their importance for financing is concerned, the first preference is given to equity (45%) followed by REITs (40%), debt (30%), prelaunch (25%) and FDI/FII is (20%).

Table 23 Benefit Options by Launching the Project in REITs

In (table 23) the benefits by launching the project in REITs have been discussed. It is observed that the first preference is faster delivery of projects which is (45%), easy access for FDI is (40%), no interest to be paid (40%), provide less dependence (40%) followed by collection of funds which is (35%).
Table 24 Risk Factors of REITs

According to (table 24) the maximum risk factor is legal compliance (40%), profitability (40%), accountability and audit compliance with SEBI (40%) and regular outflow of profit which is (40%). Tax and dividend is the second highest risk factor (35%) followed by management control and sharing of profit (30%).

<table>
<thead>
<tr>
<th></th>
<th>Highly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Highly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Compliance</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Tax</td>
<td>10</td>
<td>15</td>
<td>15</td>
<td>25</td>
<td>35</td>
</tr>
<tr>
<td>Dividend</td>
<td>10</td>
<td>15</td>
<td>15</td>
<td>25</td>
<td>35</td>
</tr>
<tr>
<td>Profitability</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Management Control</td>
<td>15</td>
<td>15</td>
<td>5</td>
<td>35</td>
<td>30</td>
</tr>
<tr>
<td>Sharing of Profit</td>
<td>15</td>
<td>15</td>
<td>5</td>
<td>35</td>
<td>30</td>
</tr>
<tr>
<td>Accountability and Audit Compliance with SEBI</td>
<td>10</td>
<td>15</td>
<td>5</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Regular Outflow of Profit</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>30</td>
<td>40</td>
</tr>
</tbody>
</table>
Table 25 Factors leading to Stability and Growth

According to (table 25), the maximum importance for the growth and stability of REITs is given to favorable policy (60%), followed by better corporate governance (45%), funding (40%) and exit options (35%).

<table>
<thead>
<tr>
<th>Factors</th>
<th>Highly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Highly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exit Option</td>
<td>15</td>
<td>15</td>
<td>10</td>
<td>25</td>
<td>35</td>
</tr>
<tr>
<td>Funding</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>40</td>
<td>45</td>
</tr>
<tr>
<td>Favorable Policy</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>25</td>
<td>60</td>
</tr>
</tbody>
</table>

Table 26 Preference of Types of REITs

By analyzing (table 26), it has been observed that the preference is highest for equity (50%), followed by mortgage (30%) and hybrid type of REITs is (30%).

<table>
<thead>
<tr>
<th>Types of REITs</th>
<th>High</th>
<th>Moderate</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>50</td>
<td>35</td>
<td>15</td>
</tr>
<tr>
<td>Mortgage</td>
<td>30</td>
<td>50</td>
<td>20</td>
</tr>
<tr>
<td>Hybrid</td>
<td>30</td>
<td>45</td>
<td>25</td>
</tr>
</tbody>
</table>

4.12 SWOT Analysis for Indian REITs (as per the developer’s response and secondary data)

By analyzing the above data and the following two case studies we have discussed the strength, weaknesses, opportunities and the threats of REITs in India.
<table>
<thead>
<tr>
<th>Strength</th>
<th>Weakness</th>
<th>Opportunity</th>
<th>Threat</th>
</tr>
</thead>
<tbody>
<tr>
<td>High quality retail centers producing steady income.</td>
<td>Only focuses on retail property.</td>
<td>Attractive acquisition for its growth</td>
<td>Increasing Electricity tariffs</td>
</tr>
<tr>
<td>In term of capitalization it has largest asset in Asia –REITs</td>
<td>Increasing cost of salaries, security and cleaning affect the revenue</td>
<td>Better R &amp; M planning and energy saving measures</td>
<td>New government rules and regulation</td>
</tr>
<tr>
<td>Strong management team</td>
<td>Limited portfolio of securities</td>
<td>Growth opportunity in other Asian developing nation</td>
<td>Economic slowdown</td>
</tr>
<tr>
<td>Focuses on tenets, which Provide daily need product and services. Good quality of tenet mix.</td>
<td></td>
<td>Generate an Opportunity to company who want to adopt an asset light strategy in their business structure</td>
<td>Over Speculation in real estate</td>
</tr>
<tr>
<td>Strong credit rating e.g. Moody’s rating:A2</td>
<td></td>
<td>Open a door for government to divest the social assets to public ownership</td>
<td></td>
</tr>
<tr>
<td>Easy exit options, provides less dependence</td>
<td>Management control</td>
<td>Pre-launch of projects</td>
<td>Accountability and audit compliance with SEBI</td>
</tr>
<tr>
<td>Better corporate governance</td>
<td>Sharing of profit</td>
<td>Flow of FDI and FII,</td>
<td></td>
</tr>
<tr>
<td>Favorable government policy</td>
<td>More investment in Asia</td>
<td>More investment in equity and REITs</td>
<td></td>
</tr>
<tr>
<td>More collection of funds</td>
<td></td>
<td>Easier access to all forms of capital</td>
<td></td>
</tr>
<tr>
<td>Faster delivery of projects</td>
<td></td>
<td>Creating green index as a principle of sustainability</td>
<td></td>
</tr>
<tr>
<td>Tax transparency,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improved corporate structure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Simpler tax structure</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.13 Case study

Case study 1: Benchmarking Green: The First Investable US Green Property Indexes on REITs

FTSE Group, NAREITs, and the U.S. Green Building Council (USGBC) recently announced a jointly developed green property index for both institutional and retail investors. This first of a kind index was a collaborative effort bringing together global market leaders in US real estate indexing, REITs market expertise, and environmental building standards.

The indexes, currently in the final stages of implementation, will give investors a structured and disciplined way to measure and model the risk and reward profile of green property, using the first codified, transparent definition of listed green property. In addition, the indexes will also provide investors with new ways to incorporate principles of sustainability into their property selections and portfolios, and access this investment theme through index-linked financial products. In a press release last week, the collaborative originators explained, “The new family of green property indexes will be based on the market’s leading benchmark for U.S. real estate, the FTSE NAREITs Index Series, using green data (LEED & Energy Star ratings) from USGBC. The USGBC is a leading non-profit organization known for its development of LEED, a global green building program, and its large diverse community.

Comparatively, the FTSE global REITs universe represents around $1.07 trillion in assets and U.S. REITs account for around 48% of the universe, valued at $512 billion (source: NAREITs). The green property indexes are based on the analysis of over 14,300 LEED and 18,400 Energy Star projects that have received third-party certification based on their green achievements and performance. With around 5 billion square feet under roof, the projects and the representative owners include many of the largest green portfolios, measured as the estimated share of total portfolio value that has either LEED or Energy Star certification. Just a few of the representative green indexed REITs include Douglas Emmett (DEI), Government Properties Income Trust (GOV), Piedmont Office Realty Trust (PDM), Boston Properties (BXP), Franklin Street Properties (FSP), Brandywine Realty Trust (BDN), Vornado Realty Trust (VNO), SL Green Realty (SLG), Ashford Hospitality Trust (AHT), Kilroy Realty (KRC), Washington REITs (WRE), and Cousins Properties...
Because of the growing demand for investors seeking to understand how their portfolios will be affected and how they can reduce their risk, the new green property indexes should be well received for institutional investors. Keven J. Lindemann, CFA, CAIA, Director of SNL Real Estate explains, “We’ve been tracking the US REITs space for 18 years, and have recently been hearing more from our clients about which companies own LEED certified or Energy Star certified assets. The financial advantages to owning these assets, lower operating costs, higher resale value, it seems like that part of the story is still being written. But it’s clear that in certain areas LEED Gold or something comparable is a baseline for new office construction. And some big institutions, big pension funds, will not purchase an asset unless it has a certain level of LEED certification. Finding new ways to benchmark REITs measured by sustainability factors is strategically aimed at investors and managers that recognize that the “low carbon economy” is a major driver of economic change. This bold new initiative is a milestone product that should lead to significant opportunities for this participating in the growing market. As explained by Brad Case, PhD, Senior Vice President of Research and Industry Information at NAREITs.

"Academics have been finding that green-certified properties outperform otherwise similar non-certified properties with higher rents and higher occupancy rates, but until now there’s been no way for any investor to take advantage of that outperformance except to buy the buildings themselves or to do immense research into which REITs own green portfolios. We’ve essentially done the background work that makes it possible for investors to participate in the greening of the real estate market."

Source: Forbes

Case study 2: Delloite

Making the Economic Case for the REITs

This is usually done through consultations with investment bankers, tax and other professional advisors, preferably ones that have been involved in numerous REITs transactions. The following micro-economic factors should be considered in making this assessment:
• **Return on assets** - The sponsor should obtain or prepare a projection of the property operating results for at least the next three to five years. This can be done in conjunction with obtaining independent appraisals of the properties.

• **Appraisal** - A reputable independent appraisal firm should be involved as early as possible, to assist in the valuation of the properties to be acquired by the REITs, usually from a related party. The independent appraiser usually gives a market range, with a premium being assigned to the portfolio assembly. This appraisal data and its verification usually assist the sponsor in preparing a projection of the property operating results.

• **Environmental Assessment** - A Phase I study should be conducted on each property where such Phase I reports are older than one year, to ensure that the portfolio is free of environmental risks.

• **Quality of the Assets** - The properties being transferred should be mature, well performing properties, which do not require significant redevelopment. Because REITs pays out much of its income to its investors, significant property redevelopment is not something that should be carried out in a REITs vehicle.

• **Stability of the Cash Flows** - In the case of office and industrial properties, this will largely be determined by lease rollovers. Properties that have significant potential lease rollovers or contractual decreases in rents will require special attention when structuring the transaction. It may be that the sponsor will have to provide certain guarantees or "head leases" in order to make the property stable enough to be attractive to investors.

• **Diversification of the Portfolio** - The more concentrated the portfolio is in one geographic location, the more risky the investment is from an investor's point of view, and therefore, the investor should demand a higher return, which, in turn, will reduce the market value of the portfolio.

• **Degree of Financial Leverage** - The higher the financial leverage, the higher the potential return to the investor, but this also serves to increase risk. REITs are usually conservatively leveraged, especially if the portfolio includes
properties that do not have contractual rents (e.g. hotels) or properties in less stable markets.

- **Debt Mix** - REITs tend to favor fixed rate mortgages, to increase the stability of the cash flows.

- **Tax on the Transfer of the Assets to the REITs** - Because a tax-free rollover is not available on the transfer of property directly to a REITs, tax on recaptured depreciation and capital gains is likely to be incurred by the transferor. Although there are tax-planning strategies that can be used to minimize these taxes, tax on the transfer of the assets could make a REITs transaction cost-prohibitive.

- **Other Taxes and Costs on the Transaction** - Early in the process, management should consult its professional advisors to identify opportunities for minimizing other costs such as land transfer tax and GST.

- **Distributable Income and Distributions** - Management must adopt a definition of distributable income that will allow the REITs to operate within its normalized cash flow from operations and yet remain competitive in the market, after taking into account its anticipated cash distributions to its unit holders. Distributions are usually defined as a specified percentage of the distributable income.

- **Tax Consequences to the Eventual REITs Unit holders** - A significant selling feature of a REITs unit is the extent to which distributions will be paid on a tax-deferred basis. It is important that the sponsor determine how much capital cost allowance and other deductions will be available to the REITs to provide such tax-sheltered distributions to unit holders.

- **Critical Mass** - The gross asset base of a proposed REITs must be large enough such that the anticipated public float justifies the issue costs and the ongoing operating costs. The following macro-economic factors should be considered:
• **Overall condition of the Capital Markets** - A new issue will obviously fare better when market conditions are favorable.

• **Appetite for Yield-Producing Investments** - Throughout calendar 2001 and early 2002, there was significant appetite for stable, yield producing investments due to the dot-com meltdown. However, a sudden change in demand can greatly impact the offering price, to the point where the transaction may no longer make economic sense to the sponsor.

• **Prevailing Interest Rates** - A low interest rate environment is usually positive for a REITs, as the REITs is able to earn additional income through the spread between the yield on its properties and the interest cost on its borrowing. When bond yields are low, investors look for higher-yield vehicles, making REITs units an attractive alternative. Also, debt maturities of high interest rate loans in a low interest rate environment present opportunities for increases in yield on the REITs properties.

**Structuring the REITs vehicle**

The following are among the items that should be considered when structuring the REITs Management and Board of Trustee composition.

• **Management of the REITs** - REITs are either internally managed (i.e. they have their own officers and management) or externally managed, usually by the sponsor entity. Internal management (strategic and asset management) is now being demanded by the markets for the larger REITs that have the requisite critical mass. More recently, where the REITs is externally managed, there has been a move to a shared management platform with the sponsoring entity. The REITs, in these circumstances, has first call on the time of the shared management resources. Certain conflicts need to be addressed, such as whether the REITs will compensate the sponsor on a flat-fee basis or on a cost-reimbursement basis. The method of compensation will have potential GST, income tax, and accounting and reporting implications, and should be addressed in advance.
• **Management of the Properties** - Again, REITs that have attained a certain critical mass of properties may find it more economical to internally manage their properties. Often, however, it makes sense for external property managers to be hired, especially where the property managers have history with the property being transferred, and the properties are geographically widespread.

• **Composition of the Board of Trustees** - This will depend somewhat on the degree of continuing involvement that the sponsor wishes to have. In most cases, the more independent trustees there are, the more investors are likely to feel like their interests will be protected, especially where the sponsor retains control or significant influence.

• **Governance** - Good governance is essential for the continuing success of the REITs, as the market places a premium on this attribute. The market needs to be made aware of the REITs commitment towards a strong corporate governance mandate.

• **Degree of Continuing Involvement of the Sponsoring Entity** - See the previous discussion on this topic.

**Accounting and Reporting Issues**

Applicable accounting recommendations and securities commission reporting rules will significantly impact how a REITs transaction and IPO are reported to investors. Financial, accounting and income tax matters that should be considered prior to formation of the REITs are:

• Does the transaction qualify for fair value accounting (both from the REITs and the sponsor's point of view)?

• How will the sponsoring entity report its investment in the REITs units (consolidation, joint venture, and equity or cost method)?

• Are there any restrictions on the amount of gain or loss that the sponsoring entity can recognize on the transfer to the REITs?
• How will any financial instruments exchanged in the transaction be accounted for (e.g. convertible debentures, secured debt)?

• What reporting will be required in the future for related party transactions (i.e. between REITs and sponsor)?

• Accounting for current and future income taxes on the transaction.

• Impact on the carrying values of other assets and liabilities on the balance sheet of the sponsor (e.g. deferred financing costs, intangible assets, etc.).

Legal and Administrative Considerations

Legal and administrative considerations include:

Long Form Prospectus

Applicable securities legislation in most provinces will require a long form prospectus, which includes a preliminary prospectus to be filed in advance of marketing the IPO, and a final prospectus when pricing has been agreed upon and the securities commissions and stock exchanges have given their approval on the prospectus documents. A long form prospectus for a REITs IPO usually includes, at a minimum: Significant detail around the structure of the transaction, properties to be transferred, management of the REITs and risk factors;• Historical financial information for the properties to be acquired, which includes balance sheets for the last two years and income statement and cash flow statement for the last three years;• An auditors' report on the historical financial information (Note - this requirement should be addressed early in the process in case the historical information has not previously been audited);• Full management discussion and analysis on the historical financial statements;• A pro-forma balance sheet and income statement for the properties, which includes the historical financial information for the most recently completed year adjusted for the effects of the proposed IPO and transfer of property;• A compilation report on the pro-forma financial statements;• Interim financial statements where a significant period of time has passed since the most recently audited balance sheet date covered by the historical financial information in the prospectus;• A review report on the unaudited interim financial statements from the
REITs auditors;• An opening balance sheet and auditors' report thereon for the REITs;• A forecast statement of net income and distributable income for the REITs, covering a period of twelve to eighteen months (This is not a statutory requirement, but is usually required by the lead under writers and is); and• An auditors' report on the examination of the forecast. These requirements change from time to time. Guidance on the requirements should be obtained by discussing the applicable securities legislation with the REITs securities lawyers and auditors. The contents and timing of the prospectus should be agreed upon and a working group established as early as possible in the process. When there are concerns about the interpretation of securities legislation or the requirements for the prospectus, it is often advisable to obtain advance clearance from the securities commissions on the reporting requirement. Potential investors do not look favorably upon a significant change in the contents of the prospectus between preliminary and final.

Legal Agreements

Legal documents to be drafted by the REITs legal counsel include:

- Trust indenture;
- Underwriting agreement;
- Property management agreement (if applicable);
- REITs management agreement (if applicable);
- Property purchase and sale documents;
- Development and Services agreements (if applicable);
- Debt assignment and/or assumption consents and agreements;
- Lease assignment and consents (if applicable); and
- Mortgage assignments and consents (if applicable).
Although these documents will likely change several times throughout the process, it is important to agree, in principle, with the underwriters on what material legal documents will be required and the key elements of such agreements early in the process.

**Securities Commission and Stock Exchange Approval**

The filing of a preliminary prospectus allows securities commissions to review the transaction and determine whether to give approval to the proposed sale of securities. Because there are thirteen securities commissions in Canada (one in each of the provinces and the territories), one of the securities commissions will usually act on behalf of all of the others, although all of the commissions have the right to comment on the prospectus.

Comment letters issued by the commissions may include:

- Questions on the accounting treatment proposed or used in the prospectus financial statements;
- Questions and directives on the contents of the prospectus document; and
- Questions on the legal structure and compliance with securities legislation.

Responses to comment letters should be developed in consultation with the appropriate legal counsel and the REITs auditors. Upon filing of the preliminary prospectus, management will obtain a conditional approval for a listing on the relevant stock exchange, which may also comment on the prospectus, its contents and the marketing of the units.

**Other Matters and Legal Documents Required**

The securities commissions, underwriters and other parties to the transaction will require, among other items:

- A comfort letter from the REITs auditors on the financial information contained in the preliminary prospectus, since the various auditors' reports will not be signed until the final prospectus.
• Consent letters from any parties whose reports will be referred to or reproduced in the prospectus (such as the auditors, appraisers, etc.). At a minimum, the auditors’ consent letter will need to be filed with the final prospectus.

• A comfort letter from the auditors to the underwriters to assist the underwriters in fulfilling their due diligence requirements under securities legislation. The contents of the letter should be agreed upon between the underwriters, management and the auditors well in advance of the date of the final prospectus to minimize last minute disruptions to the IPO process.

• The due diligence process by the underwriters' legal counsel. This will include, among other things, a view of material agreements, leases and financial information, as well as questions of management and the auditors.

4.14 Conclusion

Since the first Asian REITs was floated in Japan, over the past four years, Asian REITs have achieved compelling market capitalization. Some other Asian government are considering REITs as an alternative financing mechanism, which offers liquidity, security and diversified benefits. The growth of Indian REITs is continuing at a rapid pace. Using SWOT analysis framework, the current Asian REITs market statues was examined, the findings and its implications were summarized as follows: Firstly, current Asian real estate investment market with strong supply and demand of REITs product reflects that REITs have been widely accepted by most of major real estate industrial participants: financial institutions, real estate owners and developers, and common investors. For REITs’ suppliers, by transferring the ownership, their financial situation was upgraded and the financing options were broadened. For REITs’ investors, the impressive return/risk profiles just satisfied the common investor’s favors -- looking for safe investment. Considering the trend of increased real estate securitization and the fact of Asian specific demographic, the future REITs market will be quite bright. Secondly, Asian government plays the most crucial role in establishment and development of Asian REITs. The different results between two cases: the case in Singapore, whose government promoted the REITs progressively; the other case in Hong Kong and Korea, whose government put more restrictive rules on REITs at initial stage, clearly
evident that a REITs legislative environment will impact the development of REITs market greatly. Gaining the lessons from this point, it suggests that Asian governments should review the REITs legislation and provide more favorable regulations, such as: allow tax transparency and overseas investment, comfortable gearing limitation, flexible management structure, and so on. Thirdly, as Asia is a region with diversified economic environments, it is important to look at each country as distinct and separate markets. Each REITs market in Asia (such as Japan REITs market, Hong Kong REITs market, Malaysia REITs market) are actually evolutes at various stages and these differences were fundamentally due to the levels of immature real estate market system and legislative system. No doubt, Asian REITs were established in imperfect conditions: most of Asian REITs regimes were created by the motivations to re-shape the local real estate market or divestment of “problem” real estates. Therefore, theoretically speaking compared to US and Australian REITs markets, there are more potential risks in Asia. Last but not least, the SWOT analysis also indicates that extreme speculation disobeys the main purpose of creation of REITs as an investment vehicle. Especially for Asian investors, who have experienced the financial crisis and speculative property market in the late of 1990s. The stable attractive dividends and the diversification benefits should be the major objective for REITs investors to pursue. Overall, with overwhelming favorite factors surrounded, the current Indian REITs markets are progressing well, and it is expected that Indian REITs will be moving forward steadily.