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THE POTENTIAL FOR REAL ESTATE INVESTMENT TRUSTS IN SINGAPORE

ABSTRACT

Since the Property Market Consultative Committee, which was appointed by the Government, recommended the introduction of Equity Real Estate Investment Trust (EREIT) in February 1986, a few empirical studies have been done to assess the impact of REITs on the Singapore property market. Unfortunately REITs are yet to be introduced in Singapore. In view of the success of REITs and REIT-like instruments in the US, UK etc, this study sets out to investigate the potential for REITs in Singapore. It is found that in view of the disadvantages of direct property investment, investors in Singapore want access to larger properties, liquidity and reduced investment risk through unitised/secured property vehicles such as REITs.

Key words: REITs, Singapore, investors, securitised, unitised, potential

The buoyancy of the property market of Singapore between 1986 (ie since the last depression) and the first half of 1997 made Singaporeans euphoric about property investment in the country. Several Singaporeans became wealthy during the decade through speculation in properties, especially residential properties, because of, inter alia, phenomenal growth in capital values. According to figures from JLW Singapore (1997), average residential property value increased by 53%, commercial property value escalated by about 95% while industrial property value more than doubled between 1993 and 1996. While several people have profited through property speculation, many others have been discouraged from property investment because of the low initial yields of below 5% while the relatively high property prices have precluded many keen investors to result in the domination of the market by a handful of major investors – banks and listed property companies. Thus any measure which makes the highly priced properties accessible and attractive to many more investors is likely to benefit the property market as a whole.

In view of this, the idea which was mooted by the Property Market Consultative Committee in February 1986 in relation to the introduction of Equity Real Estate Investment trusts (EREITs) to tackle the problems of unpredictable demand, excessive supply and loss of market confidence so as to revive the then depressed market seemed to be in the right direction.

Unfortunately, no REIT-like instrument has been established yet in Singapore¹. Perhaps people were lulled by the spectacular performance of the property market between 1986 and 1997² into being oblivious of the fact property investment is risky and that it is plagued with illiquidity, indivisibility, large capital outlay etc to constrain the inclusion of property as an asset class in institutional portfolios. However, these drawbacks have been successfully circumvented by the creation of securitised and unitised property vehicles in the mature markets of USA and Australia. Thus, this paper attempts to explore the viability of replicating the success of securitisation and unitisation through REITs in Singapore.

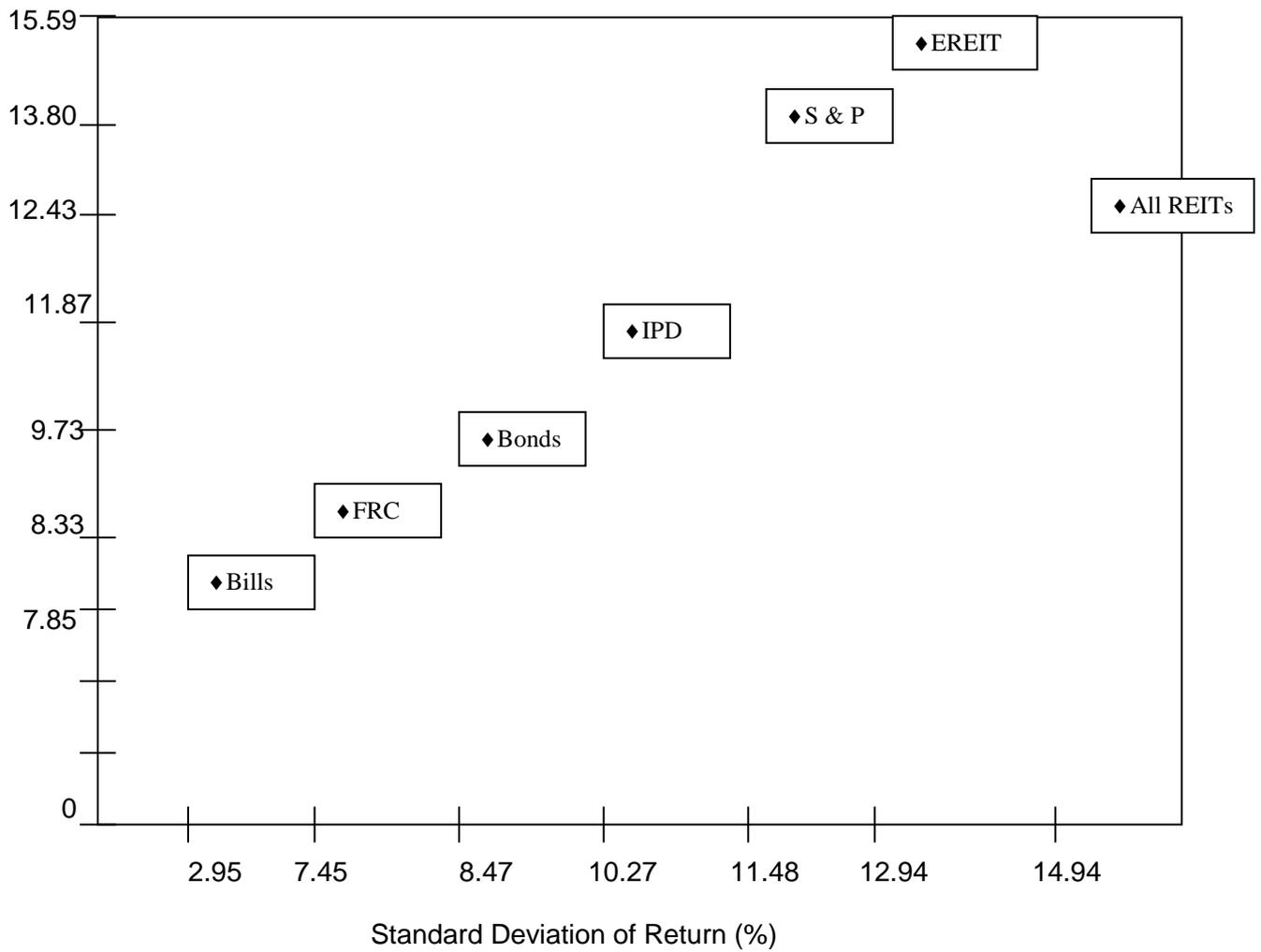
LITERATURE REVIEW

Property securitisation has been the focus of several research studies over the years. Newell and Fife (1995) investigated the attitudes of major property investors to property securitisation by conducting two surveys in Australia in October 1991 and July 1992. The study demonstrates a strong support for property securitisation in Australia. The study further reveals that accessing higher value assets and achieving investment spread are as important to investors as the desire for liquidity.

According to McNeil (1995), and Downs and Hartzell (1995), the greatest advantages of investment in REITs are its liquidity and tax-transparency. It must be cautioned however that tax-transparency could prove to be a serious disadvantage to REITs during a market depression as the “inflexible” conditions upon which it is granted forced several REITs in the US to be liquidated in 1973. This does not mean that tax-transparency is not an advantage. However, trustees of REITs should note that tax-transparency could prove to be a two-edged sword depending on the rules governing it.

A significant finding of these two studies is that REITs perform more like equities than real estate. This finding has been concurred in a study by Jones Lang Wooton (JLW), Sydney (1996) which reveals that the return of Listed Property Trusts (a type of REIT) in Australia is negatively correlated to direct property return. However some researchers have controverted this finding. Giliberto and Mengden (1996) find that REIT and direct property cash flows are positively correlated, and that any observed differences are caused mainly by the disparity in their valuation parameters. Similarly, Mueller and Laposa (1996) analyse REIT’ characteristics by their property-type groups to conclude that the groups performance synchronizes with that of their respective underlying property-type (see also Ko et al; 1995; Eichholtz, 1997; Ghosh et al, 1996; Geltner, 1991). The only conclusion which may be drawn from these conflicting findings is that although REIT is supposed to be an investment in real property which is denominated in shares, it is a hybrid “instrument” which is neither real property nor equity investment. This conclusion could be substantiated by the finding of McNeil (1995) that the average annual return for equity real estate investment trust (EREIT) – 15.59% - for the period 1978 to 1994 was higher than those for equity (13.80%) and real property (8.33%) as measured by the Standard and Poor 500 Stock Index (S&P500) and Russell-NCREIF Property Index (FRC); whereas the return for all REITs (12.43%) is slightly lower than the mean for the equity but higher than that of real property return (see figure 1; also JLW Advisory Sydney, 1996)

Figure 1: Risk and Return by Asset Class (1978 – 1994)



Source: JLW Research, USA

According to Jun Han and Youguo Liang (1995) comparing REITs return to the S&P500 index overstates the performance of REITs relative to the stock market portfolio. Furthermore, they find that REITs return vary over time.

The relatively high average annual REIT's return over the years, especially in the early 1990s, could be attributable to capital rate arbitrage that resulted from the then low cost of capital. Thus, rising interest rates could reduce the potential for capital rate arbitrage to lower REIT's return (see Stern and Redding, 1994; Chan, Hendershott and Sanders, 1990; Sanders, 1996). Scherrer and Mathison (1996 a & b) have opined that as real estate prices in the US improve to raise the cost of REIT capital, and the return from other asset classes rises, REITs should seek new sources of capital and invest internationally to generate higher returns than could be obtained from solely investing in domestic real properties. However, international diversification raises, among other things, the problem of exchange rate risk which, according to Scherrer and Mathison, could be mitigated by hedging. It must be cautioned that the benefits of hedging are a function of the volatility indices of the relevant currencies (see Addae-Dapaah and Chua, 1996; Solnik, 1996) consequent on which hedging should be done only after a careful scrutiny of the costs and benefits.

In the ASEAN region, however, the Malaysian Property Trust (MPT) was the first to be established. Since the launch of the first MPT in 1989, three more listed MPTs³ have been launched. Although modeled after the Australian Property Trust, the MPT is not tax-transparent. Kok and Khoo (1995) track the performance of the three listed MPTs against the stock market from January 1991 to March 1994 by calculating the Adjusted Sharpe Index, Treynor Index and Adjusted Jensen's Ex-Post Alpha Index. During this period, there was insignificant trading activity and price movement in the MPTs other than a sudden jump in prices in Decemeber 1993 which was shortly followed by a sharp fall to a level marginally above the original price. Kok and Khoo (1995) conclude that MPTs perform worse than unit trusts, mutual funds and selected portfolios of stocks, and suggest that they are a poor form of investment.

Azim (1994) gives a few possible reasons for the MPTs' insignificant activity – lack of prime properties for the MPTs to invest in, the strict guidelines under which MPTs operate, and the failure of the investing public to understand that the MPT is generally a long-term investment.

The recommendation of the Property Market consultative Committee (1986) with respect to the introduction of EREITs in Singapore has prompted a few literary works on the topic.

Seek (1987) comments that the problem of excessive supply (one of the major culprits of the 1985-6 property market depression in Singapore) appears to be

a symptom of a more fundamental problem – the lack of depth in the Singapore investment market, and property trusts, if accepted, can play a significant role in strengthening the property market. The cyclical nature of any property market is not unusual but the particularly high volatility of the Singapore market suggests a strong presence of highly speculative elements and a lack of strong long term investment interests. In more mature property markets, such as the UK, USA, and Australia, long term investors play a significant role in moderating the peaks and troughs of the market – they give the market more depth.

In view of this, Seek (1987) proposes the setting up of property trusts similar to the LPTs in Australia which are almost identical to EREITs.

Damon (1989) concurs that the introduction of property investment through tradable securities would widen the base of the local market, spread risk, release development capital more efficiently, attract overseas investors with possibly different investment profiles, encourage the growth of local fund management groups, and allow local investors wider access to international diversification.

The liquidity benefits of securitisation of property investment have been well documented (see Bhasin et al, 1996).

However, the contention that long term investors via REITs would play a significant role in moderating the peaks and the troughs in the property market may appear euphoric. REITs could do nothing to ameliorate the property market depression of the 70s and the late 80s in the U.S. REITs were rather a victim to the depression. Similarly, the presence of long term investors in the UK could not forestall the damaging UK property market depression of the 1974 and especially that of the late 80s to the mid 90s during which the capital value of the city of London office portfolios depreciated in the order of 25% per annum (see Mulhall, 1992; Sailing, 1993). Between July 1991 and July 1992, Land Securities' share price fell by 27%, British Land's share price lost 44% of its value, while Slough Estates' share value fell by more than 50% (Financial Times, 1991 and 1992)⁴. These figures are more alarming than the 21.2% average annual fall in office property values in Singapore between the third quarter of 1981 (market peak) and the first quarter of 1986 (bottom of depression). Furthermore, LPTs in Australia could not thwart the ravages of the Australia's property market depression of the late 80s to the mid 90s. Therefore, it would appear to be a far cry

to presume that the introduction of REITs in Singapore could moderate the peaks and the troughs of the property market. This contention may be reinforced by the fact that the existence of listed property companies (another indirect, albeit different, form of property investment) in Singapore could not ameliorate the recent property market depression. The stocks of listed property companies were battered by the property market depression to precipitate a 55.13% fall in the Stock Exchange of Singapore Property Stock Index (SESPSI) by the end of 1998 (see figure 2). The critical question is whether REITs in Singapore can withstand, and even forestall, property market depression(s) in the country when other (albeit dissimilar) indirect investment vehicles have failed.

Property market cycles are a function of, *inter alia*, inelastic supply and volatile demand which cause the market to be in a perpetual disequilibrium. Since REITs cannot eradicate these peculiarities of the property market, it would appear inconceivable for REITs to moderate the peaks and troughs of the property market. In addition, since REITs are believed to be more akin to stock than real property investment, it could be argued that the introduction of REITs in Singapore could exacerbate the swings in the property market since investors can easily invest and disinvestment. Similarly Damon's (1989) proposal that the Single Property Trust is the most suitable for Singapore is questionable as overseas experience show that multi-asset trust vehicles are potentially more beneficial.

In addition to replicating the above findings, Koh et al (1991) feel that the existing framework for unit trusts in Singapore could be used for REITs. They further suggest that governmental and institutional participation in REITs, coupled with permitting the use of one's savings in the Central Provident Fund (CPF) – the equivalence of Social Security in the West – for investment in REITs would boost the success of REITs in Singapore. Certainly governmental sponsorship (in any form) of REITS will more than guarantee its success. However one may question the rationale for such preferential treatment which was not accorded to unit trusts and property companies. Furthermore, even though the release of CPF savings for REITs will undoubtedly encourage Singaporeans to invest in REITs, most pension consultants may be horrified by the utilization of one's retirement funds for an investment which offers no guarantees. However, the desirability of employing CPF savings for risky investment(s) is beyond the scope of this paper.

Tsan (1995) investigates the financial feasibility of REITs in Singapore to conclude that REIT is an attractive investment vehicle for Singaporeans. The variables in his model are property price indices for Urban Redevelopment Authority (URA) and Jones Lang Wootton (Singapore), and the Stock Exchange of Singapore All-Share and All-Properties indices. It must be noted that the use of indices from different sources could be problematic.

Furthermore, the listed property companies whose share prices constitute the All-Properties index engage in business activities which are not related to properties. The law governing the property companies are likely to be different from those of REITs. Thus using the above parameters as a proxy for REITs may leave something more to be desired.

A BRIEF SURVEY OF SINGAPORE PROPERTY MARKETS

The performance of the Singapore property market (all sectors), the office market and the property stock market from 88Q1 to 98Q4 is depicted by figure 2. It is evident from figure 2 that both the property market and the office market synchronize with the property stock market in their cyclical movements. While the property market peaked in 96Q2, the property stock market peaked in 97Q1. By the end of 1998, the property market index (URAPPI in figure 2) had fallen by 43.88% from its peak in 96Q2. In contrast, the index for the office market (URAOPI in figure 2) , with a stock of 5,733,000m² as of 98Q4, fell by 38.77% over the same period whereas the SESPSI plummeted (from its peak in 97Q1) by 55.13% by 98Q4.

PROFILE OF PROPERTY INVESTORS IN SINGAPORE

An appreciation of the profile of investors is a pre-requisite to ascertaining the potential success of REITs and/or any securitised or unitised investment vehicle(s) in Singapore. Banks, some government bodies and public-listed property companies are the main investors in commercial properties in Singapore. In contrast to the west, institutions (insurance companies and pension funds) are noticeably absent from the property market. CPF, the only superannuation fund in Singapore, invests in property indirectly through the members withdrawal of their savings for the purchase of properties. On a direct basis, CPF invest in overseas properties through the Government of Singapore Investment Corporation.

Furthermore, most of the public-listed property companies and some large, established private companies such as Far East Organisation and Kuok Singapore are active in residential developments which are sold on completion for short-term profit. Individuals and smaller companies are the main investors in residential properties predominantly but not exclusively for owner-occupation.

As Jurong Town Corporation and the Housing Development Board (both of which are statutory bodies) own most of the industrial properties, only a small proportion of industrial properties are owned by private companies and individuals mostly for owner-occupation.

Figure 2: Property and Property Stock Indices (1988-1998)

ACCESS TO COMMERCIAL PROPERTIES – SMALL INVESTORS

The only route to commercial property ownership by the small retail investors is via the Strata Title System Commercial properties which are in multiple ownership include Golden Mile Complex, Lucky Plaza, Far East Shopping Centre and Kim Seng Shopping Centre. The supply of good quality strata titled commercial properties is very limited. The most recently available Grade B office space was two 44-storey towers of Suntec City which were strata-titled on a floor-by-floor basis, each floor of an average size of 10,000 sq ft (930 sq m). The average sale price of \$1,800 psf (\$19,375 psm) which translated to an absolute average of \$18 million was not affordable to the “ordinary man-in-the-street”. It was not surprising therefore that one tower was predominantly purchased by multinational corporations such as Hyundai, BASF and some financial institutions for owner-occupation, while the other tower was bought by local and foreign companies mainly for investment. Whilst strata-title is a solution to the lumpiness of property by giving access to ownership on a divided scale, it has its limitations. The system is based on divided ownership but the cost of management and maintenance of the building structure and common parts is apportioned to the owners by a formula laid down by legislation (see the Strata Title Act). Furthermore, small investors may indirectly invest in commercial properties by purchasing shares of property companies which are listed on the Stock Exchange of Singapore (SES).

METHODOLOGY

The study is based on a survey of 153 (i.e. about 22%) randomly selected institutional investors. Institutional investors were targeted for the survey mainly because they are relatively more knowledgeable about REITs and other modes of indirect property investment and thus, could provide a more informed response to the survey which addressed the following key issues:

- existing direct and indirect property investment portfolio;
- advantages and disadvantages of direct property investment;
- general attitude towards REITs and indirect property

The sample of 153 institutions is composed of the Banks, Life Assurance/Insurance companies, securities companies, Fund management companies, Property developers, Corporate entities and others such as property and financial advisers. Questionnaire survey forms were sent to the institutions by facsimile and/or mail, followed by a telephone call to

ensure that the interviewees had received the questionnaire and to complement the postal/facsimile survey with telephone survey. The response rate of the survey which was conducted from 28 April 1997 to 30 May 1997 was 41.2% (i.e. 63 respondents).

PROFILE OF RESPONDENTS

The respondents to the survey represent a broad spectrum of reputable institutional investors (see table 1) who are managing assets of varying magnitude (see table 1). The total value of portfolio managed by the respondents is approximately S\$63 billion.

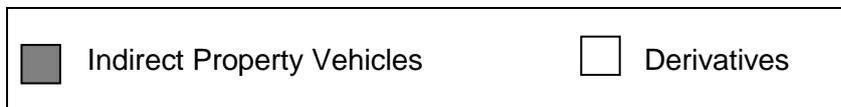
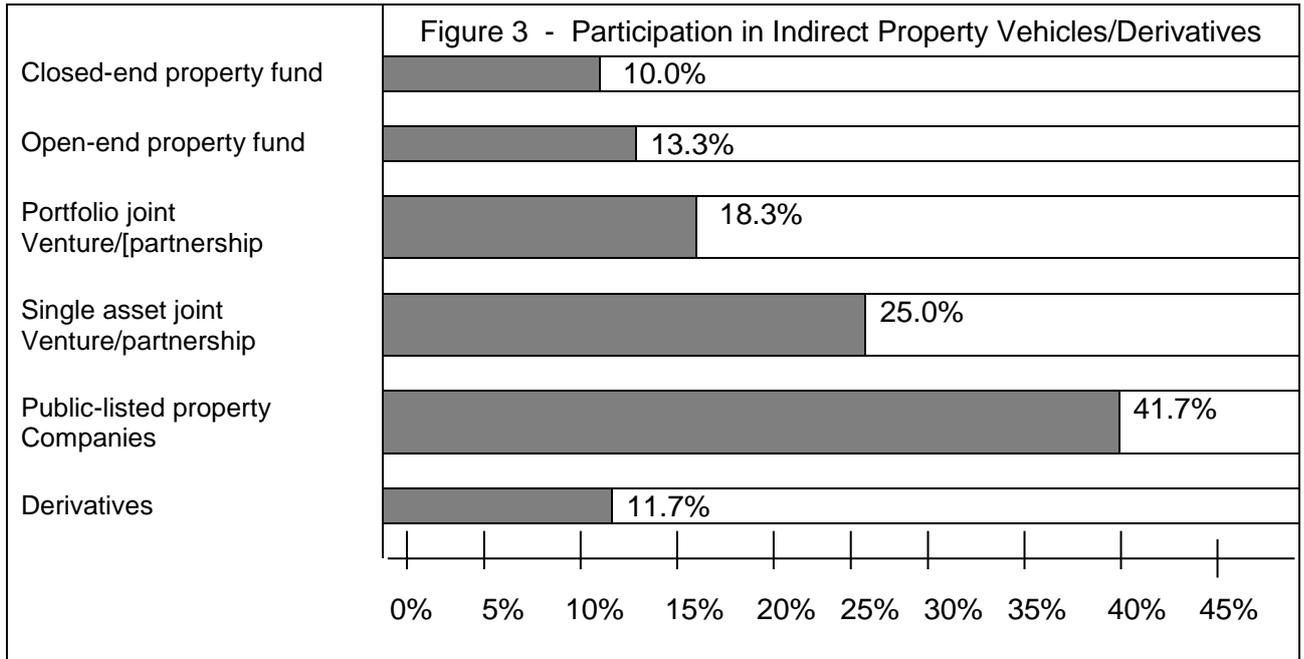
Table 1

PROFILE OF RESPONDENTS

ASSETS MANAGED (S\$M)							
RESPONDENT	<50m	51m – 100	101 – 250	251 – 500	501 – 1000	>1000	Total
	%	%	%	%	%	%	%
Property Developer	2	1	1	2		-	6
Fund Management Co.	3	4	2	2	1	1	13
Securities Co.	9	2	5	9	-	-	25
Insurance Co.	-	-	-	-	3	10	13
Offshore Bank	-	-	-	-	6	4	10
Lending Bank	-	-	-	-	-	3	3
Merchant Bank	-	-	-	-	-	3	3
Investment Bank	-	-	-	-	3	3	6
Investment Co.	7	2	1	1	-	-	11
Other Company	8	1	1	-	-	-	10
Total	29	10	10	14	13	24	100

Source: Based on authors' survey.

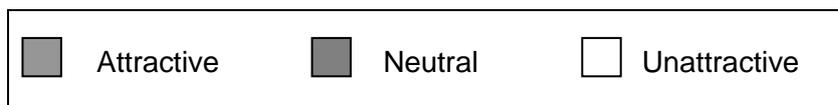
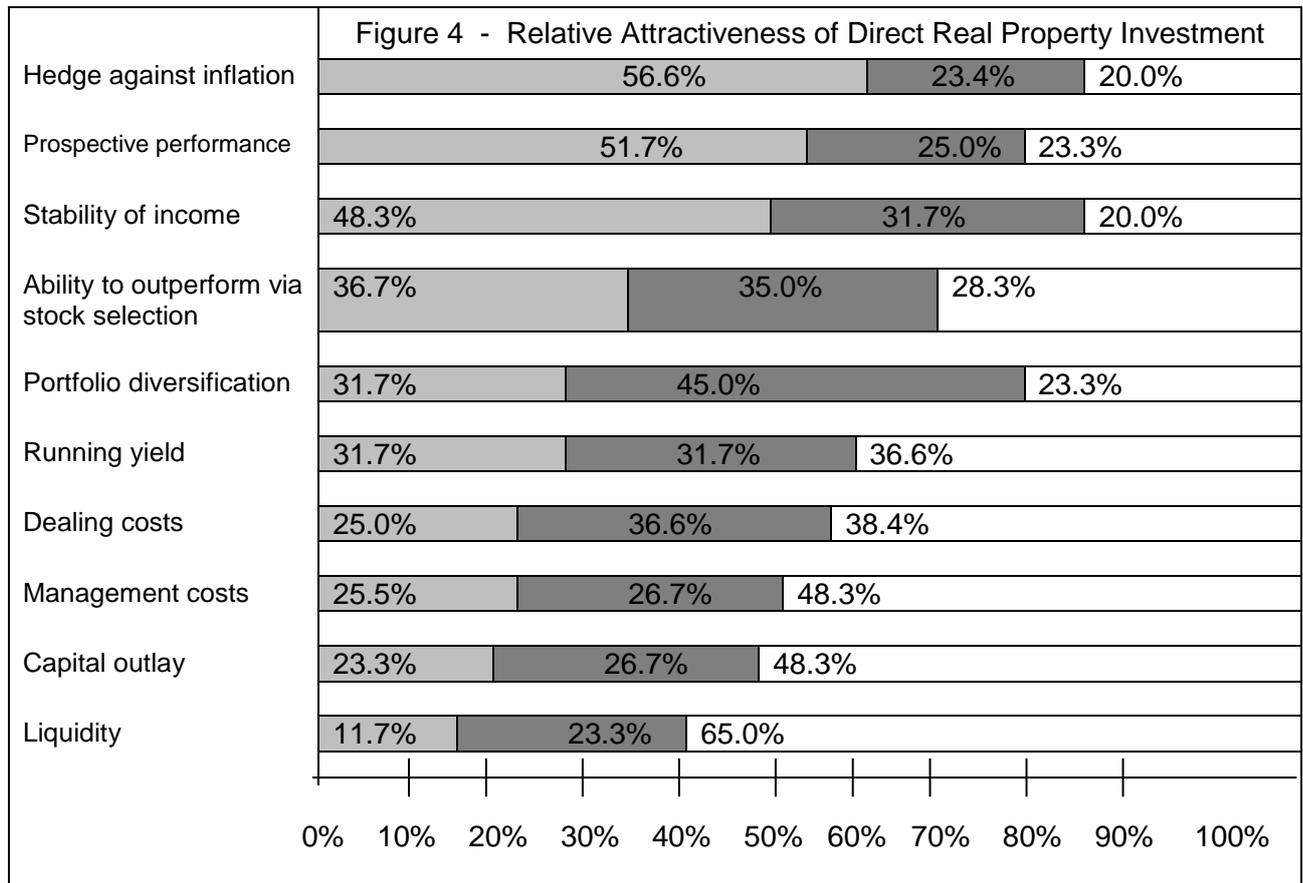
It must be noted, however, that the majority of the respondents (68%) do not directly invest in real property. Of the remaining 32% respondents about 16%, 5% and 11% directly invest between 1% and 10%, 11% and 20%, and 50% and 100% of their assets respectively in real property. Among those in the 50-100% range, all but one allocate 100% of their assets in real property. It is not surprising to note that these group of respondents are property developers and property companies. Furthermore, the survey results show that about 37% of the respondents can (under their current investment guidelines) invest in indirect property vehicles while 30% can invest in derivatives. Figure 3 details this group's participation in indirect property vehicles and derivatives.



Source: Authors' Survey

REAL PROPERTY AS AN INVESTMENT MEDIUM

The respondents' assessment of the relative attractiveness of direct property investment is presented in figure 4.



Source: Authors' Survey

With a relatively low annual inflation rate of about 3% vis-à-vis the spectacular performance of the property market especially between 1992-96 (see introduction) and a geometric average annual exponential capital appreciation rate of 12.77%⁷ for the period 1980 – 96 inclusive, it is not unexpected that inflation hedging and prospective performance potential of direct property investment rank highly as a merit. Similarly, the finding that the problem of liquidity, capital outlay and management cost significantly cause direct property investment to be relatively unattractive (see figure 4) confirms common knowledge. Furthermore the respondents' acknowledgement that the running yield (usually below 5% annually) makes direct property investment relatively unattractive while prospective performance makes property investment attractive would appear paradoxical. However the apparent contradiction could be explained by the relatively high appreciation of property values, especially over the past few years (see introduction), which more than compensates for the relatively low running yields to give credence to respondents optimism. In addition, a long term annual average redemption yield of 16.7% per annum (based on the computed average exponential property value appreciation of 12.7% over the past 17 years and in initial yield of 4% per annum) is good enough to justify the respondents optimism about prospective performance of direct property investment.

NEED FOR PROPERTY SECURITISATION/UNITISATION

According to the respondents to the survey, securitisation/unitisation is primarily needed to:

- (a) facilitate “access” to larger properties (56.7%);
- (b) reduce risk in property investment (i.e. price hedging) (55.0%);
- (c) promote liquidity (55.0%); and
- (d) spread risk (i.e. sector hedging) (43.3%)

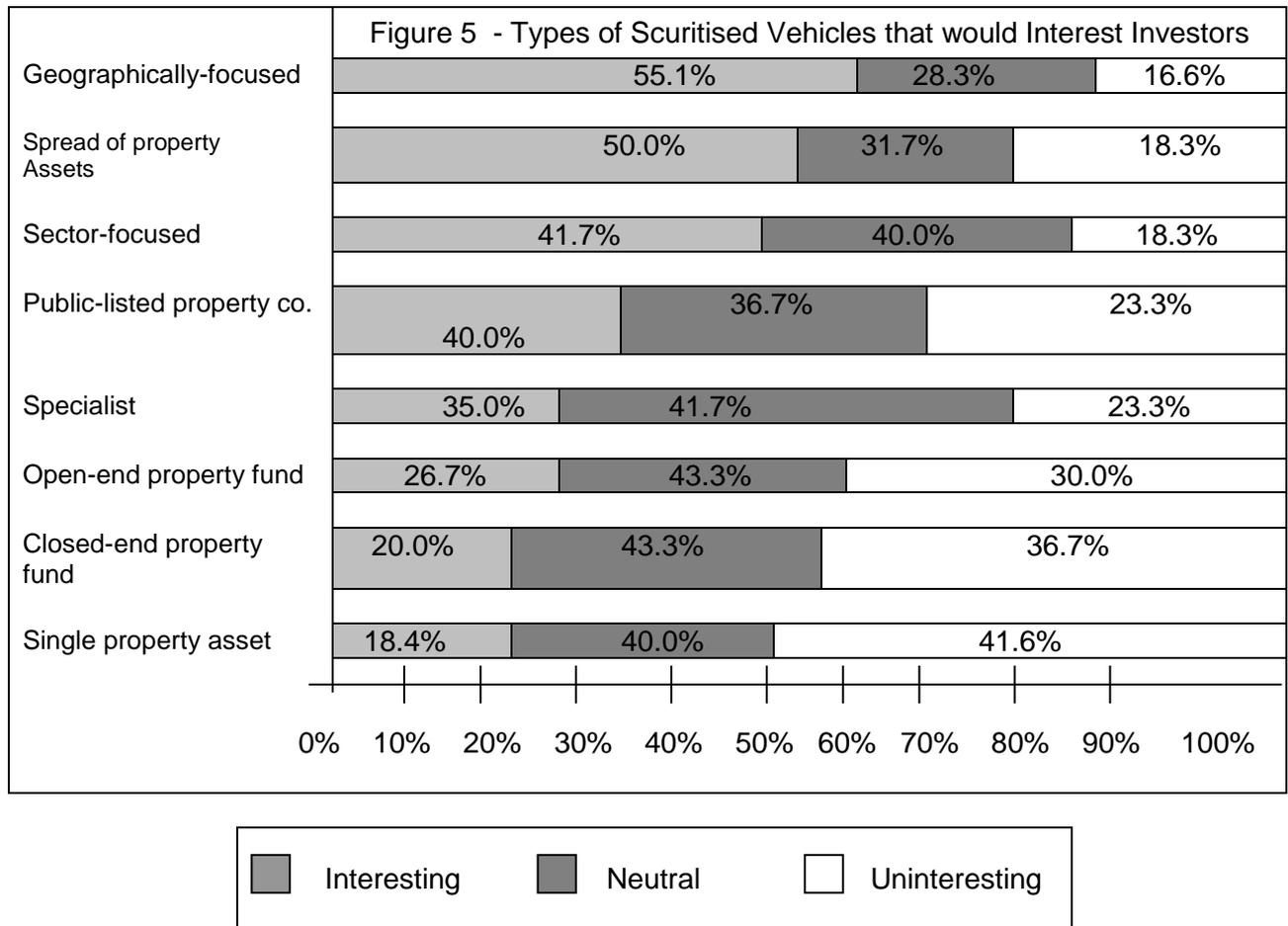
Furthermore, whereas 42.9% of the respondents think that these indirect property investment vehicles will probably be a substitute for direct property investment, 52.41% of them think otherwise. Only 4.7% think that the indirect property investment vehicles will definitely be a substitute for direct investment in property. The attitude of the portion of respondents, who currently invest directly in property, towards the indirect property investment vehicles is similar to that of the whole group of respondents. Of those who currently hold direct property investments, 57.5% will continue to invest directly in property; 36.5% will probably stop, while 6% will stop, investing directly in property if suitable, liquid, tax-efficient indirect property investment vehicles existed. These figures should not be construed to portend a dismal prognosis for indirect property investment vehicles in

Singapore. The decision not to substitute indirect property investment vehicles for direct property investment is an interim tactical move. According to those who will stick to direct property investment, they will rather wait, monitor and convince themselves of the stability and relative attractiveness of any indirect property market, as measured by liquidity and performance, before substituting it for direct investment in property.

According to the results of the survey, 93% of all the respondents are very receptive to, and welcome the introduction of, REITs in Singapore. Only 7% of the respondents are sceptical of the success of REITs in Singapore. This minority group is not certain of the sufficiency of demand for REITs. This pessimism is, however, not buttressed by any market research.

Figure 5 presents the types of securitised vehicles that appeal to investors.

Figure 6: TYPE OF SECURITISED VEHICLES THAT APPEAL TO INVESTORS



Source: Authors' Survey

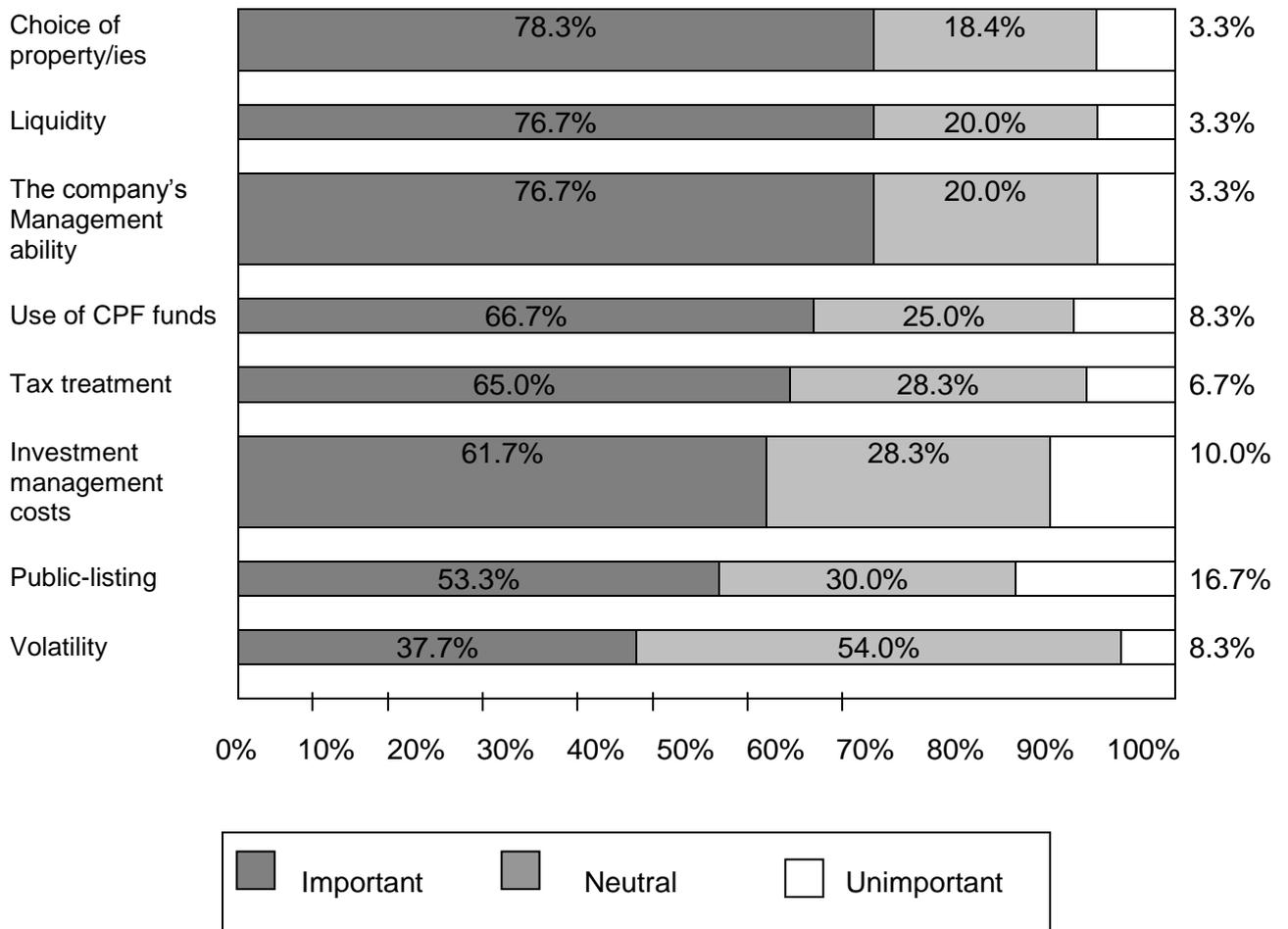
It is obvious from figure 5 that REITs which have portfolios which are diversified geographically (ie. internationally) to include a variety of property types would be more appealing to investors than any others. The relative smallness of the property market of Singapore significantly constrains diversification of direct real property investment in the country. It is therefore reasonable for astute and potential investors in REITs to desire international-portfolio trusts. This is in consonance with the proposal of Scherrer and Mathison (1996) that REITs should invest internationally to generate a relatively higher return than can be realised from purely domestic real property investment. Furthermore; it could be deduced from figure 6 that a single property asset REIT would be quite undesirable to potential investors. This finding negates Damon's (1989) proposal that "the Single Property Trust was the most suitable for Singapore'.

According to the results of the survey, all the listed factors (see figure 6) which may affect the success of REIT are important. However, the respondents to the survey consider the quality of properties in a REIT's portfolio to be prejudicial to its success. Similarly, liquidity and the company's management ability are considered to be critical determinants of a REIT's success in Singapore (see figure 6). The fact that 66.7% of the respondents consider the use of CPF as a major determining factor of success implies that the success of REITs in Singapore could be seriously impaired unless the government allows CPF members to use their CPF savings to invest in REITs. As far as Singaporeans are concerned, the ability to use CPF savings for investment in REITs would tantamount to the government's sponsorship of REITs. Apart from boosting the morale of the investors, it will enable Singaporean investors to invest in REITs without having to sacrifice a portion of their spendable income. This has been the foundation of the success of house ownership in, and the catalyst for the buoyancy of the property market of, Singapore. It will certainly considerably promote the success of REITs.

Even though taxes are relatively low in Singapore (the highest income tax rate being 28% while corporate tax is 26%) the respondents to the survey consider favourable tax treatments as a relatively important success factor for REITs. Damon (1989) warned that the strict regulations on which tax transparency is based could undermine REITs in Singapore during adverse economic conditions as evidenced by the US experience. However, this fear would appear to be unfounded because during the 1986 property market depression of Singapore, the government reacted quickly to forestall foreclosures to pre-empt the collapse of business entities. At the time of writing, the government has taken measures (including relaxation of some rules) to ensure that the current over-supply of property and currency turmoil do not undermine the property market. Thus, one may safely

conclude that favourable taxation would enhance, rather than negate, the success of REITs in Singapore. In addition, it is worth noting that even though public listing is a success factor, it is almost at the bottom of the scale of success factors. Similarly, volatility is relatively insignificant. Perhaps, the respondents, who are seasoned investors, have accepted risk as an inevitable function of investment.

Figure 6: SUCCESS CRITERIA FOR REITs



Source: Authors' Survey

As for as managing REITs assets is concerned, the respondents are of the opinion that management should devolve upon, in descending order, specialist fund management houses (26.8%), merchant/investment banks (23.5%), life assurance/insurance companies (16.8%), property companies (16.8%) and property consultants (16.1%). It is almost paradoxical that inspite of all property consultants expertise in property management, they are the least favoured for managing REITs assets. It could be that the respondents consider REITs to be more a financial instrument than real property investment and therefore deem fund managers to be more suitable than property consultants to manage REITs. This may imply that the success of REITs in Singapore could spell disaster for property consultants (by taking business away from them) unless property consultants can prove to REITs trustees that they, property consultants, are knowledgeable in, and capable of, managing financial instruments and therefore REITs. It would appear that expertise in fund management would be vital for the survival of property consultants when REIT is successfully implemented in Singapore.

CONCLUSION

The study has shown that there is an overwhelming support for the introduction of REITs in Singapore. The majority of the respondents (93%) are certain that REITs will be well received by the investing community of Singapore. Although the sample size of the survey is relatively small, the survey targeted the possible REIT “market movers”. Furthermore it was discovered during the survey that the respondents are very well informed about REITs. Thus, it may be concluded that the findings of the study are reliable albeit the relative smallness of the sample size.

Among the most important determinants of the success of REITs in Singapore is the use of CPF savings to invest in REITs and tax concession for REITs. This implies that REITs must perform be “Approved REITs” (ie. they must be approved by the CPF Board). One of the criteria for approval is that the trust should have paid dividends for the proceeding three financial years to the date of application for approval. Whether this rule would be relaxed for REITs to be “Approved REITs” from the very inception is a matter for negotiation. If approval is not given at the inception, the demand for REITs stock would come solely from institutional investors who, according to the study, are receptive to REITs. After establishing themselves in the first few years, REITs should easily achieve approved status to enable private Singaporeans to use their CPF savings to invest in REITs. Though public listing is almost at the bottom of the success criteria scale (see figure 6), it is imperative for achieving

“Approved” REITs status as well as ensuring liquidity which is a critical determinant of success.

It suffices to state that a conducive and efficient regulatory environment exists under the supervision of Monetary Authority of Singapore and the Stock Exchange of Singapore to ensure the smooth operation of future REITs in Singapore.

Since the proposal of the Property Market Consultative Committee (1986) implies the implementation of EREITs which are a replica of the US model of portfolio based, tax transparent trusts, it may be safely concluded that REITs would be accorded tax transparency in Singapore. The granting of tax transparency status (which is the key attractive feature of REITs) to REITs will accord to the government’s drive to make Singapore the financial hub of South-east Asia. However, we must remember the old adage “noblesse oblige”. Tax transparency warrants REITs to comply with certain legal requirements. It was reported in the Straits Times (1999) that the Real Estate Development Association of Singapore (Redas) has held a few meetings with the Monetary Authority of Singapore (MAS) to discuss REITs in Singapore. The only statement that MAS has made about when REITs will be introduced in Singapore is “MAS is currently finalising the regulatory framework for property funds. Details will be announced when this is finalised” (The Straits Times, 1999).

Given the strong inclination of Singapore towards the U.S. it is likely that the legal framework for REITs in Singapore will be similar to what exists in the US⁸. This means that REITs in Singapore will have to satisfy the Asset, Income and Distribution Requirements⁹ to qualify for favourable tax treatment.

In addition to liquidity, favourable tax treatment and sound regulatory environment, a REIT must offer “reasonable” annual return to appeal to shareholders/unitholders. Unfortunately, Singapore is notorious low running yields of between 3% and 5%. This could pose a serious problem if prospective investors require higher yields. However, low initial yields could be balanced by a relatively high long term exponential mean annual capital appreciation of about 13% which is tax free as there is no capital gains tax in Singapore.

The Honourable Lim Hng Kiang (Singapore’s then Minister for National Development) said:

As Singaporeans have always been interested in property investments, pension property funds will be well received by them. However, the private sponsors must decide whether or not there is sufficient demand to launch pension property funds in Singapore (Lianhe Zaobao, 1997).

It would appear that the private sector is ready for the introduction of REITs in Singapore. All the interested parties are waiting for MAS to come out with the regulatory framework for the launch of REITs in Singapore.

NOTES:

1. It was reported in the Straits Times of Thursday, 4 January 1999 that Singapore's first REIT might be launched towards the end of 1999.
2. The euphoria about property investment in Singapore has been dispelled since the second half of 1997 when the ravages of the South East Asian currency crisis took its toll on the weakened Singapore property market. Since the 1996 property market peak, average property values have fallen by about 44%.
3. The property trusts in Malaysia are Arab-Malaysian First Property Trust, First Malaysian Property Trust, Amanah Harta TANAH PNB and Mayban Property. It has been acknowledged by the Malaysian market and the relevant authorities that the property trusts market has been in active, and that current legislation does not allow the trusts to be aggressive.
4. Although these figures relate to property company shares, which are different from REITs, they are a potent negation of the contention that long-term investors play a significant role in moderating the peaks and troughs of the market. Since long term investors via property companies could not counteract the property market depression, it would appear inconceivable to argue that long term investors via REITs could moderate the peaks and troughs of the property market.
5. The Singapore private property market (for which indices are constructed) is made up of 164,000 private residential units and 11,612,880m² of office, retail and industrial space. The value of the market is calculated to be about S\$300 billion as of the end of 1998.
6. According to available figures from the Stock Exchange of Singapore, there are 22 listed property companies. The market capitalisation of the mainboard (Singapore incorporated / S\$ traded) property companies was about S\$15.2 billion as of the end

of January 1999 (see SES Journal, February 1999). At the time of writing, S\$1.7080 = US\$1.00/

7. The exponential mean annual capital appreciation was computed from the property price index compiled by the Urban Redevelopment Authority of Singapore. The Singapore Private Property Price Index (quarterly) compiled by the URA is presently the only index available that measures price changes of various types of properties over time and is generated using median transaction prices and the fixed base weighted Laspeyres formula:

$$I_{on} = \frac{\sum \left(\frac{P_n^i}{P_o^i} P_o^i Q_o^i \right)}{\sum (P_o^i Q_o^i)} 100$$

where I_{on} = Property price index for current period n compared to base period 0 (base year: 1999)

P_{ni} = Average selling price (\$/m²) of a single property of type "i" in current period n

P_{oi} = Average selling price (\$/m²) of a single property of type "i" in base period 0

Q_{oi} = Quantity of property type i sold in base period 0

$P_{oi}Q_{oi}$ = Transacted value of property type "i" in the base period (weighting factor)

The index is a price relative of the current price per square metre of a type of property compared with that in the base year, 1990. The average selling price used to compute the index based on the fixed base weighted Laspeyres formula is the median instead of the mean. The index is generated from the transaction prices of properties in the Caveats lodged with the Registry of Titles and Deeds (in the Singapore context, a caveat is usually lodged by the purchaser to protect his/her

interest soon after an option to purchase a property is exercised or a sale/purchase agreement is signed).

8. The requirements which REITs in the US should satisfy to qualify for favourable tax treatment are as follows:

Asset Requirements

- At least 75 percent of the value of a REIT's assets must consist of real estate assets, cash, and government securities.
- Not more than 5 percent of the value of the assets may consist of the securities of any one issuer if the securities are not includable under the 75 percent test.
- A REIT may not hold more than 10 percent of the outstanding voting securities of any one issuer if those securities are not includable under the 75 percent test.

Income Requirements

- At least 95 percent of the entity's gross income must be derived from dividends, interest, rents, or gains from the sale of certain assets.
- At least 75 percent of gross income must be derived from rents, interest on obligations secured by mortgages, gains from the sale of certain assets, or income attributable to investments in other REITs.
- Not more than 30 percent of the entity's gross income can be derived from sale or disposition of stock or securities held for less than six months or real property held for less than four years other than property involuntarily converted or foreclosed on.

Distribution Requirements

- Distributions to shareholders must equal or exceed the sum of 95 percent of REIT taxable income.

9. The Asian countries do not have much to offer Singapore as far as REIT is concerned. The Japanese authorities are currently formulating regulations for REIT. Securitisation of real estate is gaining currency in Japan. In the summer of 1998, Meiji-era Yamato Seimei Building in Central Tokyo was successfully securitised. Furthermore, Sumitomo Realty and Development Company has announced its decision to securitise some of its commercial buildings while Fukoku Mutual Life

Insurance Co, the Japan Development Bank, Nomura Securities Co. and a real estate firm are co-operating to fund the construction of a building through securitization of real estate.

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