

Coming Soon: REITs

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Investing in real estate in the Philippines is not for small investors. Real estate investment requires a fat wallet because real property is expensive and because the investor will not be able to readily sell such investment should he suddenly need cash. Also, real estate investments are successful only if the investor has the expertise to identify the income potential of real properties and the competence to administer these. Otherwise, the results of the investment will be based on sheer luck.

To address these obstacles to participation by small investors in the real estate industry and to provide for their protection, Sen. Edgardo Angara filed Senate Bill No. 63 and his son Congressman Juan Edgardo Angara filed House Bill No. 148 both entitled “ An Act Providing the Regulatory Framework for Real Estate Investment Trusts and for other purposes.” If passed, this will introduce to the Philippines an investment vehicle that has experienced phenomenal growth in the Asia-Pacific region known as the REITs.

Globally, a REIT is an investment vehicle which holds income-producing real estate or real estate-related assets. Its main features are that REITs acquires property, has a manager who provides professional management services for the REITs portfolio, issues instruments evidencing the investment in the REIT which are listed in a stock exchange, distributes to investors at least on an annual basis most or all of its net income and enjoys tax benefits in the acquisition of property and in the distribution of income to investors provided certain statutory conditions are met. These conditions usually include maintaining a minimum percentage of the REIT’s assets in real estate, deriving a significant portion of its gross income from rents on real property or interest on its mortgage investments, keeping borrowing levels below a certain level, and maintaining a high dividend payout ratio (90% of the taxable income in the US, Singapore and Japan, and 100% of the taxable income in Australia).

What are the benefits that can be derived from a REIT? Through a REIT, small investors enjoy the benefits of owning real estate but with the added advantage of liquidity. The investors can dispose of his real estate investments or rotate his real estate portfolios in an efficient manner. For real estate developers and operators, this will provide a more effective access to capital markets which will support the growth of the real estate industry.

The Trust Officers Association of the Philippines (TOAP) recognizes the benefits of REITs and fully support the REIT bill. “We believe that REITs are vital to the growth and development not only of the capital market but also the national economy as it promotes increased investment activities. REITs offer a means for portfolio diversity and the potential for stable long-term growth associated with owning property for both small and large investors,” says TOAP President Ma. Lourdes T. de Vera.

Recent developments in capital markets across Asia illustrate that REIT benefits are not limited to developers and investors. One emerging trend- which is already benefiting Singapore – is that

investors are increasingly viewing infrastructure as an asset class in its own right and giving the sector specialized focus. Traditional project financing through bank debt is being overtaken by capital market financing solutions like infrastructure funds. In Japan, the first infrastructure REIT, the Industrial & Infrastructure Fund, was launched in October 2007. According to World Bank estimates, Asian infrastructure projects will require US\$250 billion to US\$300 billion worth of financing every year for the next few years. While infrastructure requirements have in the past been financed largely by governments, the present big demand for new infrastructure means that private sector investment will also be required. For the Philippines, which is trying to achieve a balanced budget this year, the REIT provides the ability to tap the capital market to finance the planned increase in our infrastructure assets. The ability to obtain adequate funding is key to achieving our projected growth rate as infrastructure assets form the foundation of economic development. In this light, the REIT has the potential to become a major contributor in achieving fiscal health.

In global practice, the REIT primarily uses the legal form of a trust, hence the reference to “trust” in its name. As investors invest via a trust contract, this form is also referred to as the “contractual form” of the REIT. Some countries use the legal form or a corporation primarily incorporated to invest in income producing real estate and securities of real estate corporations.

Originally the drafts of the REITs Bills adopted the corporate form of the REITs. The Trust Officers Association of the Philippines (TOAP) proposed to the Senate Technical Working Group (TWG) that for maximum flexibility and to align with global practice, the bill should also include the trust or the contractual form. Moreover, providing investors with two competing forms or options will bring out the best in the product categories, thereby redounding to the benefit of investors. It is also an important consideration that for other products such as investments funds, there is the corporate form (called the mutual funds) as well as the contract form (called the UITFs). In the Securitization Act of 2004, there is also a provision that a special purpose entity for securitization can be a special purpose corporation or a special purpose trust. Thus, the corporate and the contractual forms can co-exist side by side in these product lines.

The TOAP cited that in other financially advanced countries like Australia, Hong Kong, Malaysia and Singapore, REITs are typically established by way of contract and not as stock corporations. This is true of Singapore, where the REITs are called Property Trusts, which currently has probably the most conducive environment for REITs in the Asia Pacific Region. This is also true of Australia, where REITs are called Listed Property Trusts (LPTs), which has a mature and sophisticated REIT market. LPT assets stood at A\$106 billion as of 2006 while Property Trusts reached over S\$25 billion as of February 2007. Based on the growth and success of unincorporated REITs in these countries, the TOAP is convinced that REITs established by way of contract are as effective and efficient as REITs established by way of incorporation. In some countries like Japan, the REIT takes the form of a listed company whose primary purpose is to own income-producing real estate assets and real estate securities.

As of this writing, the present version of the Senate Bill includes the trust (contractual) form of REITs. However, as the bills are a work in progress and any discussion of specific provisions will be premature. The work of the Senate and House technical working groups consists in

balancing the need of the country to catch up with the Asia Pacific region in offering REITs with the need to provide maximum protection to small investors.