THE BUSINESS TIMES

FRI, JUL 03, 2015

Reit rule changes seen as 'balanced' and less severe than expected

MAS: Enhancing safeguards for investors and unitholders weighed against growing a vibrant Reit market

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At a glance

JUL 3, 2015 5:50 AM

Singapore

THE Monetary Authority of Singapore (MAS) has released a list of rule changes governing real estate investment trusts (Reits), which - to Reit managers' relief - are less stringent than the proposals made last October.

But while most industry observers see the changes as a good balance between boosting corporate governance and giving Reits operational flexibility, a few had hoped for a firmer stand from the central bank on the controversial issue of performance fees and acquisition/divestment fees payable to managers.

MAS's position on the rules was shaped by feedback from stakeholders such as Reit managers, sponsors, industry associations, investor groups and individuals.

On operational flexibility, it has implemented a single-tier leverage limit of 45 per cent (up from 35 per cent for an unrated Reit); it has also raised the development limit for a Reit from 10 per cent to 25 per cent of its deposited property.

MAS believes the 45 per cent leverage limit is a balance between preventing Reits from over-gearing and reducing mechanistic reliance on credit ratings. The higher development limit, to come with with conditions to mitigate risks, will let Reits rejuvenate their maturing portfolio of assets.

To improve governance, MAS has imposed a statutory duty on Reit managers to prioritise the interests of unitholders over the manager's, in situations of a conflict of interest.

The regulator also moved ahead on improving the independence of the manager's board of directors - by requiring that at least half the board be independent directors (IDs) if unitholders are not allowed to appoint the directors; if they are, the proportion of IDs falls to a third.

But on the touchy topic of fees (performance fees as well as acquisition and divestment fees),

MAS opted for the "transparency" route, that is, to require more disclosures, rather than the "prescriptive" route of dictating how these fees should be calculated.

This is to ensure that fee structures are investor-aligned and are not open to abuse by managers who may seek to grow the Reit's assets without working towards a corresponding growth in shareholder returns.

MAS said it has chosen not to prescribe a list of permissible methodologies for calculating performance fees "because Reits vary in business models and each methodology has its merits and shortcomings". This should be left to the market to decide.

On acquisition/divestment fees, MAS also decided to require Reit managers to disclose the justification and methodology used - less onerous than the earlier proposal of replacing such fees with one determined on a cost-recovery basis.

DBS equity analyst Derek Tan said that, in addition to more disclosures, MAS could have tightened performance-fee structures by offering some "best practices" guidelines.

Chua Tiow Chye, the Reit Association of Singapore (Reitas) president, on the other hand, said he believed the market would regulate itself and competition will make managers more aware of the need to align fee structures to unitholders' interests. "There is no one set of fees which can be prescribed, and which will serve all asset classes and across different geographies... We see more new Reits implementing fee structures more directly linked to DPU growth, hence there may be no need for prescriptive methodologies to set fees."

David Gerald, president and chief executive of Securities Investors Association (Singapore), urged all Reit managers to adopt the changes and to go beyond disclosures and justifications on fees to actively engaging unitholders and explaining how the fees are derived to avoid misunderstandings.

Overall, National University of Singapore associate professor Mak Yuen Teen found the enhancement of governance to "reasonably commensurate" with the operational flexibility allowed, but is skeptical that Reit managers will allow unitholders to elect the IDs. He also found the newly imposed statutory duty on managers to be merely theoretical, "nice on paper but difficult to enforce".

"I would be very surprised if managers gave unitholders the power to elect directors, which raises the question of how independent those directors are going to be, if it is essentially the Reit manager, and therefore the sponsor, who appoints and removes the IDs," said Prof Mak, who is in the middle of creating a corporate governance rating for Reits and business trusts.

Above all, the balance between rigor and leniency is seen as a way of helping Singapore's Reit sector to grow in a saturated domestic market while facing regional competition; Lee Boon Ngiap, MAS' assistant managing director of capital markets said the finalised positions take a balanced approach to enhancing safeguards for investors and unitholders and growing a vibrant Reit market.

The changes will be phased to give Reit managers time to implement them. Changes to the Collective Investment Schemes Code take effect in January 2016; those to the Securities and

Futures Act start a year after that. New requirements on performance fees will be extended to no later than the first AGM of the financial year ending on or after Dec 31, 2015.

The changes are not expected to affect the anticipated listings of Manulife US Reit, KaiLong China Reit and a Reit from CIMB-TrustCapital Advisors.

MAS clarified that internally managed reits - where those in management are employees of the Reit - are allowed in Singapore. All Reits here are now externally managed.

On Reit consolidation, it added that it is prepared to consider applications from managers to run more than one Reit, if these managers have the expertise and can mitigate potential conflicts of interests.