

RESPONSE TO FEEDBACK RECEIVED – REVIEW OF THE REGULATORY REGIME GOVERNING REITs

On 10 June 2005, MAS issued a Consultation Paper inviting comments on proposals to enhance the property fund guidelines (the “Guidelines”) in the Code on Collective Investment Schemes (the “Code”). The proposals sought to strengthen oversight of REIT managers, augment the requirements applicable to related party transactions, enhance disclosure requirements to better empower investors in making informed decisions, and incorporate flexibility in key areas to accommodate domestic and overseas expansion by REITs.

The consultation period closed on 11 July 2005 and comments were received from 16 respondents (listed in the Annex). MAS has carefully considered all the comments received and have incorporated them, where appropriate. MAS thanks all respondents for their views on the proposals in the Consultation Paper. Comments of wider interest and our responses are set out below.

Section 1: Introducing a Regulatory Framework for REIT Managers

A. Licensing Framework

Q1: MAS proposed to require REIT managers and representatives to be licensed and regulated under the SFA licensing regime. MAS also sought feedback on the admission criteria for REIT managers and their representatives.

Public Comments:

The majority of respondents agreed with the proposal to license REIT managers under the SFA. There were suggestions that the regulations applicable to REIT managers should be customised, or separate regulations established instead of requiring REIT managers to comply with existing business conduct rules that apply to fund managers. Several respondents sought clarification on the standards of competency and expertise required of REIT managers and their representatives, examinations for representatives and transitional arrangements for existing REIT managers.

On the location of the REIT manager’s key officers, some respondents felt that it should not be mandatory for the Chief Executive Officer and all directors to be based in Singapore. For a REIT that owns foreign assets, it may be preferable to a REIT manager if it has some directors based where the properties are located.

MAS' Response:

REIT management will be defined as a separate regulated activity under the Securities and Futures Act (“SFA”), with corresponding rules and regulations relevant to the activity. In the interim, REIT managers who meet the new requirements of the Guidelines in the Code can continue to operate REITs constituted as Collective Investment Schemes (“CIS”). To enable MAS to exercise proper oversight over REIT managers and their operations, REIT managers will have to designate a Chief Executive Officer (“CEO”) and have at least two professional staff that are based in Singapore. The CEO, directors and professional staff of REIT managers should satisfy fit and proper criteria as set out in the “Guidelines on Fit and Proper Criteria”

[Guideline No: MCG-G01]. REIT managers should also maintain a physical office in Singapore and have minimum shareholders' funds of S\$1 million.

A separate consultation on the proposed amendments to the SFA and its subsidiary legislation in relation to the regulatory requirements that will apply to REIT managers will be conducted at a later stage. Existing REIT managers will be given a reasonable timeframe to apply for their licences and comply with the relevant regulatory requirements.

B. Core Activities of a REIT manager

Q2: MAS proposed that REIT managers should be required to perform the following activities in Singapore:

- (a) investment strategy formulation;
- (b) investor relations including procedures to handle queries and complaints;
- (c) compliance/accounting; and
- (d) financing (raising of debt and equity).

MAS also sought views on whether the requirement to have the above activities performed in Singapore would cause operational difficulties for REIT managers.

Public Comments:

Several respondents disagreed with the proposal to require REIT managers holding foreign properties to carry out their investment and financing activities in Singapore. They felt that flexibility in the location of activities should be accorded to attract foreign REITs. They were also of the view that REITs should be allowed to carry out investment and financing activities outside of Singapore to enable better matching of assets and liabilities, gain access to more favourable cost of financing and deeper capital markets, as well as achieve greater tax efficiency. Some other respondents supported the proposal, but expressed concerns over possible operational difficulties in requiring certain activities (such as compliance and accounting) to be performed in Singapore, due to foreign regulatory requirements.

MAS' Response:

The Singapore office should play a meaningful role in the core activities of the REIT manager, including investment management and financing activities if these are carried out outside Singapore. The participation of the Singapore-based CEO and directors in investments and financing decisions is one factor that MAS would consider in assessing the role of the Singapore office.

REIT managers will have to maintain proper records and audit trails of their investment and financing activities in the Singapore office. MAS notes that some compliance and accounting activities may have to be carried out overseas to comply with foreign rules and regulations. Nonetheless, the Singapore office is expected to have oversight responsibilities for a Singapore-listed REIT. As the REIT will be listed on SGX and offered to the retail public in Singapore, MAS will also expect the investor relations function to be located here.

Section 2: Improving Corporate Governance Practices

A. Unitholders' meetings

Q3: MAS proposed to codify in the Guidelines that a meeting may be convened at the request of at least 50 unitholders or unitholders representing 10% of units. MAS also sought views on whether REITs should be required to hold annual general meetings (“AGMs”).

Public Comments:

The majority of the respondents were in favor of MAS codifying the above proposal and not mandating the need to hold AGMs. However, a respondent suggested that the proposal is not an adequate substitute for the requirement to hold an AGM, as it requires unitholders' action and hence, would be unlikely to happen unless something very serious occurred.

MAS' Response:

MAS recognises that AGMs provide a platform for investors to query decisions made by the REIT manager on a regular basis but is of the view that at this stage of development of the REIT market, codifying the above proposal would provide an adequate avenue for unitholders to requisition a meeting when there is sufficient interest to do so.

B. Removal of REIT managers

Q4: MAS proposed to prescribe one of the following options with respect to the removal of REIT managers:

- (a) 50% of unitholders who are present and voting with no unitholder being disenfranchised; or
- (b) a consensus representing 75% of the outstanding REIT's units, with units held by the manager and related parties being disenfranchised.

Public Comments:

The views were divided. Respondents in favor of option (a) were of the view that related parties should not be disenfranchised as their interests are also at stake. On the other hand, respondents in favor of option (b) took the position that disenfranchisement is necessary to remove conflicts of interests and allow decisions to be made by independent unitholders.

MAS' Response:

MAS is mindful of the repercussions that may arise from disenfranchising REIT managers and their related parties. It could lead to the removal of REIT managers who, together with their related parties, hold controlling stakes. On balance, MAS is of the view that option (a) is more equitable and serves to align economic with controlling interests of share ownership.

Section 3: Aligning interests of REIT managers and unitholders and enhancing the role of trustees

A. Payment of property acquisition/disposal fees to REIT manager

Q5: MAS proposed to require the REIT manager to disclose, in dollar quantum, the following during an acquisition:

- (a) acquisition fee payable to the REIT manager; and
- (b) if a profit forecast is made,
 - (i) the expected incremental income to the REIT; and
 - (ii) the expected incremental base and performance fee payable to the REIT manager.

As for disposals of properties, MAS proposed that the REIT manager disclose the disposal fee, in actual dollar quantum, payable to the REIT manager and substantiate why the disposal would be in the interests of unitholders.

In addition, MAS sought views on whether the payment of the acquisition and disposal fee to the REIT manager should be made in the form of units priced at the date of the transaction (at higher of market price or NAV per unit) and if a moratorium period of one year should be imposed on such units.

Public Comments:

Most respondents were agreeable to the suggested disclosures at the time of acquisitions and disposals. However, there were divergent views on the issue of payment of acquisition and disposal fees (“Transaction Fees”) to the REIT manager in the form of units. Several respondents supported the proposal, on the grounds that payment of fees in units brings about greater alignment of interests between the REIT manager and unitholders.

On the other hand, it has been pointed out that the function of acquisition or disposal of properties could be outsourced to a third party for which a similar fee may be paid in cash. One respondent also commented that it would be optimal for the REIT to pay Transaction Fees in cash (financed by borrowings) instead of units if the REIT has low gearing given that cost of debt is normally lower than that of equity. Unitholders’ returns would be diluted if units were issued to fulfill payment obligations.

MAS’ Response:

Requiring a REIT to pay Transaction Fees in units helps to ensure that the incentives of the REIT manager and unitholders are better aligned since the manager shares in the benefits or otherwise of the transaction as a unitholder. MAS recognises that the issuance of units as consideration for Transaction Fees may not always be in the best interests of unitholders because it may in some circumstances dilute the interests of existing unitholders. However, the subjective nature of the valuation of properties and the remuneration structure of REIT managers can compound the potential conflicts of interests inherent in interested party transactions (“IPTs”). So it is important that the interests of the manager are aligned with those of unitholders as far as possible in these types of transactions. Hence, on balance, MAS will require Transaction Fees to be paid in units only for IPTs. There will also be a one-year moratorium on the sale of

those units. MAS believes that the benefits of mitigating the potential conflicts of interests outweigh the potential costs.

B. Augmenting guidelines on interested party transactions

Q6: MAS proposed to augment the Guidelines on interested party transactions by requiring the following:

- (a) the REIT to obtain two independent valuations of the properties, with one of the valuers commissioned independently by the trustee;
- (b) in the case of an acquisition, the transaction price cannot be above the higher of the two independent valuations;
- (c) in the case of a disposal, the transaction price cannot be below the lower of the two independent valuations; and
- (d) the trustee to provide written confirmation that it is of the view that the transaction is at arm's length and the terms are in the interests of unitholders where:
 - (i) unitholders' approval for the transaction is not required;
 - (ii) in the case of an acquisition, the final transaction price is not at the lower of the two valuations; or
 - (iii) in the case of a disposal, the final transaction price is not at the higher of the two valuations.

Public Comments:

Some respondents agreed with the proposal to require two independent valuations of the properties when transacting with interested parties. However, other respondents commented that having two independent valuations would add to the costs of transactions. One respondent remarked that unitholders' interests would be adequately protected even with one valuation because the trustee endorses the commissioning of the valuer.

MAS' Response:

Most REITs are sponsored either by a property developer or a property holding company. After listing, REITs continue to acquire properties from their sponsors. While the REIT manager is required to conduct such deals at arm's length, conflicts of interests are inherent in such transactions. To address these concerns, MAS will require a REIT to obtain two independent valuations of the properties when transacting with interested parties.

C. Extending ambit of interested party to trustees of REITs

Q7: MAS proposed to extend the ambit of interested parties to include the trustee of REITs.

Public Comments:

Respondents agreed with the proposal.

D. Enhancing the Role of the REIT Trustee

Q8: MAS proposed that a REIT trustee should be required to perform additional obligations as follows:

- (a) a REIT has proper legal title to the properties it owns;
- (b) the properties have a good marketable title;
- (c) the contracts (such as rental agreements) entered into on behalf of the REIT by the REIT manager is legal, valid and binding and enforceable by or on behalf of the REIT in accordance with its terms; and
- (d) the REIT manager arranges adequate property insurance and public insurance coverage in relation to the REIT's properties.

In addition, MAS sought views on whether the REIT trustee should be required to perform any other specific duties.

Public Comments:

A majority of the respondents agreed with our proposals. One respondent suggested that the general duties for trustees set out in the Regulations should suffice.

MAS' Response:

The duties of trustees that are set out in the Regulations, though generic in nature, have in practice been interpreted to apply to CIS investing in securities. As there are differences between the ownership of properties and securities, it is appropriate for MAS to provide greater clarification on requisite due diligence to be performed by a REIT trustee to discharge its obligations to protect the rights and interests of unitholders.

Section 4: Introducing safeguards to address concerns over partial ownership of properties

Q9: MAS proposed allowing less than 100% ownership of properties and proposed the following guidelines for part-ownership of properties:

When a REIT intends to invest in a property as a part-owner, it should:

- (a) make its investment by acquiring shares in a single purpose property holding company ("SPC");
- (b) have freedom to dispose of its investment;
- (c) have veto powers over certain key operational issues of the SPC;
- (d) agree upfront with its joint venture partners on the minimum percentage of the distributable profits of the SPC that will be paid to its shareholders, and the REIT should be able to receive its pro rata share of such dividends; and
- (e) have the right to sell its shares to joint venture partners at a price arrived at using a predetermined basis, and should have the first right of refusal if its joint venture partners wish to dispose of their stake in the SPC.

Public Comments:

All respondents agreed with the proposal of allowing less than 100% ownership of properties.

While most respondents broadly agreed with the proposed guidelines for part-ownership of properties, there were suggestions that the structure of Singapore REIT investments in local and overseas markets should be left to market forces. A requirement to comply with prescribed guidelines may result in Singapore REITs having to forego opportunities that may be beneficial to unitholders.

MAS' Response:

Having considered all comments, MAS is of the view that there should be basic safeguards in place where a REIT intends to invest in a property as a part owner, so as to protect the interests of the REIT and its unitholders. MAS notes that the proposed safeguards are common features of joint venture agreements in the property industry.

Public Comments:

A respondent suggested that the SPC model be reflected as the preferred, instead of mandatory, model. This is to recognise that tax or other commercial factors might necessitate another holding structure, which MAS would favourably consider provided the joint ownership agreement reflects MAS' proposed criteria.

MAS' Response:

MAS recognises that tax or other commercial considerations may necessitate a holding structure other than that of a company. For example, it is common for properties in Australia to be held through trusts, instead of companies, for tax efficiency reasons. Hence, REITs will be permitted to invest in partially owned properties through acquiring either shares or interests in a special purpose vehicle (that could be a trust, or any other vehicle, that is set up to hold the properties). Other ownership arrangements may be permitted, on a case-by case basis, if the arrangement is necessary for the purposes of meeting legal or regulatory requirements in a foreign jurisdiction, or when there are other valid justifications.

Public Comments:

On the proposal that a REIT should have veto powers over certain key operational issues of the SPC, a respondent commented that although the list provided in the consultation paper is comprehensive, there could still be risk of deadlock or disputes. It was suggested that the constitutive documents of the SPC provide for disputes to be determined through a nominated international arbitration centre.

MAS' Response:

MAS agrees with the comment and we have incorporated a requirement in the revised guidelines that the constitutive documents of the SPC and/or the joint venture agreement should provide the mode for the resolution of disputes between the REIT and its joint venture partners.

Public Comments:

Respondents disagreed with the proposal that the REIT should have the right to sell its shares to joint venture partners at a price arrived at using a predetermined basis as it is not a commercially acceptable outcome in most situations. A respondent also disagreed that the REIT should have the first right of refusal if its joint venture

partners wish to dispose of their stake in the SPC. The respondent was of the view that it may not always be in the interests of the REIT to secure such a first right of refusal and this is a commercial matter best left to the discretion of the REIT manager.

MAS' Response:

The concerns raised are valid. MAS recognises that it will be difficult in practice to impose a requirement for the REIT to have the right to sell its shares to joint venture partners at a price arrived at using a predetermined basis. MAS also agrees with the comment that a REIT should not be forced to secure the first right of refusal. Given the foregoing and the other proposed safeguards to be implemented, MAS will not introduce these requirements.

Section 5: Enhancing disclosure on tenant profile

Q10: MAS proposed to require the following disclosures in offering documents and annual reports of REITs:

- (a) total number of tenants;
- (b) top ten tenants, and the percentage of total net rentable area and gross rental income attributable to each of these top ten tenants;
- (c) trade sector mix of tenants, in terms of the percentage of total net rentable area and gross rental income attributable to major trade sectors.
- (d) lease maturity profile, in terms of the percentage of total net rentable area and gross rental income for each of the next five years.

Public Comments:

Most respondents agreed with the proposal. However, a few respondents recommended that the disclosure requirement on the top ten tenants should be based on their percentage contribution to total gross rental income as it is a more relevant indicator of concentration risk than net rentable area. If both sets of information are disclosed, it would also be possible to work out the rental rates paid by the tenants, and such information is highly sensitive and confidential.

Two respondents disagreed with the proposal as they believed that market forces should guide the determination of the specific items for disclosure. To the extent that investors want certain information they will ask the REIT managers to provide it, and over time REIT managers will continue to service investors with the disclosures that they require to make informed investment decisions.

MAS' Response:

MAS is of the view that investors should be provided with a consistent and comparable set of information on the tenant profile of REITs so as to enable them to assess the diversification and stability of a REIT's cash flows over time, and relative to other REITs.

The requirement to disclose specific tenant information in relation to net rentable area has been removed, in recognition of the concerns raised on disclosing information on both the total net rentable area and gross rental income.

Section 6: Amending provisions on investments in property developments

Q11: MAS sought views on:

- (a) the proposal to allow a REIT to engage in the development of a property that it intends to hold in its own portfolio when completed; and
- (b) whether the proposed 10% aggregate limit on commitments in property development activities and investments in uncompleted property development is reasonable.

Public Comments:

Respondents had differing views on the proposal to allow REITs to engage in property development activities. One group suggested that the current guidelines should be retained. Some respondents disagreed with the proposal as this would result in REITs being exposed to riskier undertakings contrary to the stable income producing nature that investors expect of a REIT. Other respondents agreed with the proposal to allow REITs to engage in property development activities, with one respondent commenting that allowing REITs to engage in property development activities provides the flexibility for REITs that have property development expertise to benefit their unitholders.

On whether the proposed 10% aggregate limit is reasonable, some respondents were of the view that the exact exposure should be determined by market forces or, if there is to be a limit, the 20% limit should not be lowered. They were of the view that REITs should be accorded greater freedom to embark on such endeavors provided appropriate disclosures are made. They also pointed out that investments in property under development are allowed in the USA and Australia. A few respondents suggested excluding investments in uncompleted property developments from the limit if there are substantial pre-committed leases for the development since the risk of such investments are substantially lower.

MAS' Response:

After taking all comments into consideration, MAS is of the view that a REIT's exposure to risks associated with property development should be restricted to a small proportion of the REIT. This would ensure that the investments of REITs continue to be substantially income producing.

MAS does not agree with the suggestion not to include, for purposes of calculating the limit, investments in uncompleted property developments with substantial pre-committed leases. The pre-committed leases do not address some of the risks inherent to investments in uncompleted developments, such as the risk of insolvency of the developer.

Section 7: Introducing flexibility in borrowing limits

Q12: MAS proposed to retain the current 35% borrowing limit where the REIT is not rated. A REIT may exceed the current 35% borrowing limit so long as the REIT obtains and discloses a credit rating from a major rating agency. Total borrowings shall in no case exceed 60% of the REIT's deposited property.

MAS also sought suggestions on other disclosures that should be required to apprise investors of the risks associated with increased levels of borrowing.

Public Comments:

While respondents welcomed the proposal to provide REITs greater flexibility to determine their capital structure, most also believed that the limit could be relaxed further. The relaxation could take the form of raising the base limit (proposals range from 40% to 60%), not imposing an upper limit if the REIT is rated by a major rating agency, or not setting a borrowing limit and letting the market decide on an appropriate level of borrowing. Respondents were of the view that relaxing the borrowing limits would increase a REIT manager's flexibility to cope with changing economic conditions. It would also enhance the competitiveness of Singapore REITs vis-à-vis foreign REITs as no borrowing limits are imposed in jurisdictions such as Japan, Australia and USA. In Hong Kong, the borrowing limit was recently raised from 35% to 45%.

However, others held contrary views. One respondent was of the view that by raising the limit, MAS may signal to the market that it is safe for REITs to leverage up to the new limit. This may inadvertently result in investors putting pressure on a REIT to gear up to the new threshold to boost yields, especially if other REIT players are doing so, resulting in a race to the bottom.

MAS' Response:

REITs are intended to be relatively low risk, income generating investment vehicles. Increased borrowing results in higher debt servicing costs and could have an adverse impact on the financial stability of a REIT in a rising interest rate environment or a property market downturn.

Taking into account all the factors, MAS is of the view that the proposal to retain the 35% borrowing limit but allow a REIT to exceed that limit so long as it obtains and discloses a credit rating from any major rating agency (subject to a cap of 60% of its deposited property) strikes a good balance between the need to provide REITs greater flexibility to determine their capital structure and concerns of REITs not being able to service and repay their debts in a property market downturn. A credit rating is an independent assessment of the ability to service and repay debt. Ratings are also regularly reviewed and published, and provide additional information to investors in assessing the risks of investing in REITs and exerts market discipline on REIT managers. Hence, information on a rated REIT would help empower investors to make a more informed evaluation of the risks of their investment.

Additional Revisions

A. Moratorium on interested party transactions

A respondent commented that the guideline which prohibits a REIT from transacting with interested parties during the 12-month period following the date of the IPO may deprive a REIT from entering into transactions that are beneficial to the REIT.

MAS' Response:

Interested party transactions are already subject to guidelines which mitigate the conflicts of interests. As safeguards such as the need to obtain unitholders' approval if the transaction exceeds 5% of the value of the REIT and limits on the transaction price exist to protect unitholders' interest, the guideline has been removed.

B. Valuation of Assets

MAS has received feedback that it is costly to require a REIT that is proposing to issue new units for subscription, to perform a full valuation of all its real estate assets if the last available valuation is more than 6 months old.

MAS' Response:

MAS recognises that a REIT is already required to perform a full valuation of all its real estate assets at least once a year and property valuations are not expected to fluctuate widely over a short period of time. Requiring full valuations would also be costly for REITs with large portfolios. Hence, MAS has revised the guideline such that where a REIT proposes to issue new units for subscription and the last available valuation of the REIT's real estate assets is more than 6 months old, a desktop valuation of the assets, instead of a full valuation, would suffice.

C. Including deferred payments in revised aggregate leverage limit

Deferred payment arrangements have been utilised by REITs in the acquisitions of properties. Under such arrangements, a portion of the purchase consideration of properties is to be paid in the future, either in cash or in units of the REIT. The resulting lower upfront payment artificially inflates the initial yield of an investment, making the acquisition appear more attractive to investors than had the entire purchase consideration been paid upfront. In some circumstances, deferred payment arrangements may serve to make inherently yield-dilutive transactions less apparent to the investor. MAS has also received feedback that such arrangements are akin to loans from the vendors of the properties and hence should be included as part of borrowings, subject to the borrowing limit.

MAS' Response:

Although deferred payments are, like borrowings, employed to finance acquisitions and boost yields, MAS notes that deferred payments are different from conventional borrowings in that they are not subject to the interest rate risks that conventional borrowings entail. However, at this early stage of development of the Singapore REIT market, it is important to note that REITs are intended to be investments that provide stable long-term income. When REIT managers engage in practices that tend to dilute the long-term returns of a transaction, there should be safeguards, beyond disclosure, to influence them into performing enhanced due diligence on the transaction. MAS considers that REIT managers and the market will focus more clearly on deferred payment arrangements if such payments, together with borrowings, are counted towards an aggregate leverage limit. The aggregate leverage limit will replace the borrowing limit. REITs should also make clear and prominent disclosure of the details

of deferred payment arrangements entered into, including forecasts of distribution yields assuming all deferred payments are settled in full.

ANNEX

LIST OF RESPONDENTS

1. Colin Ng & Partners
2. DBS Bank Singapore
3. HSBC Institutional Trust Services (Singapore) Limited
4. KPMG
5. Macquarie Securities (Asia) Pte Limited
6. Moody's Singapore Pte Ltd
7. National Association of Real Estate Investment Trusts (NAREIT)
8. Real Estate Developers' Association of Singapore (REDAS)
9. SG Asset Management (S) Ltd
10. Securities Investors Association (Singapore)
11. Singapore Exchange Limited
12. Stamford Law Corporation

4 respondents requested confidentiality.