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REIT: A New Tool for Real Estate Investment and Fund Generation in Thailand

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On October 11, 2010, the Securities and Exchange Commission of Thailand (SEC) approved the regulatory framework for establishing real estate investment trusts (REITs) in Thailand. The evolution of real property financing in Thailand—from primarily bank loans to the rigid Property Fund for Public Offering (PFPO) to the proposed REIT—reflects the liberalization of the Thai market, the need for alternative funding options in the wake of the recovery of Thailand's property sector, and the need for Thailand to maintain its regional competitiveness. This article is a primer for investors, developers, and other stakeholders on the upcoming REIT in Thailand.

The Development of REITs

Thailand's commercial real estate market was historically funded primarily by bank loans, secondary offerings/IPOs, and some limited private equity. Thailand previously attempted to broaden such financing options through the PFPO, which proved to be ineffectual and unpopular due in large part to regulatory constraints that incorporate a rigid capital structure and prohibit mortgages on PFPO properties (and on the PFPO itself). Attempts at making the PFPO concept more attractive to investors by allowing a PFPO to acquire property that is only 80% completed (versus the old rule requiring 100% completion) and requiring valuation of properties every 12 months (versus every six months) have been unsuccessful. Indeed, to date there have been only two PFPOs listed on the Stock Exchange of Thailand (SET), with asset values that pale in comparison to property investments financed by alternative means.

One glaring absence from the list of financing options is the REIT—long prized in the United States for its flexibility and deduction of shareholder dividends from taxable corporate income. The lack of an REIT financing option in Thailand became all the more apparent when demand for commercial and residential real estate projects increased (due to very low interest rates) during the recovery of Thailand's property sector after the 1997 Asian economic crisis.

Recognizing the limitations of PFPOs, the SEC approved a new regulatory framework for establishing REITs in Thailand (REIT Framework) on October 11, 2010. The groundwork for the REIT Framework began with the passage of the Trust for Transactions in Capital Market Act B.E. 2550 (2007), which introduced Thailand to the previously unrecognized "trust" as a form of asset management. Thereafter, the SEC drafted regulations in consultation with the public and other interested stakeholders, culminating in the recently announced REIT Framework.

The REIT Framework

The new REIT Framework is expected to provide a modernized vehicle for financing commercial real estate investments, while also providing the flexibility that has made REITs popular at the international level. Additionally, the REIT Framework will likely supplant existing PFPO regulations entirely. The SEC has suggested that neither establishing a new PFPO nor increasing registered capital in an existing PFPO will be possible during the one-year period following the announcement of regulations governing the establishment and management of REITs, which are currently being drafted by the SEC. Converting an existing PFPO to an REIT, however, could be an option.

The REIT Framework contemplates a trust fund structure (not a juristic structure as in PFPOs) whereby the trustee shall have the legal right over the trust fund in terms of ownership and/or properties. Trust certificates will be listed on the SET. Thus, when forming and operating an REIT, one will need to take into account existing SEC rules regarding, for example, investment in properties, corporate governance, and management restrictions. REIT management companies will manage the REITs, which will require a license issued by the SEC.

Other features of the REIT Framework will ease the limitations of the old PFPO regulations, including the following:

- An REIT will have the ability to leverage up to 50% of its net asset value (NAV) (whereas current PFPO regulations allow for 10% of NAV).
- The holding restriction for affiliated companies will be increased to 50% of the total trust certificates sold (up from one-third under PFPO regulations).
- REITs will be permitted to invest in a broad spectrum of real property types, barred only from investing in immoral or illegal businesses (a PFPO is permitted to invest only in certain types of real estate projects).

Currently, the SEC is in the process of drafting rules and regulations on the establishment and management of REITs and is working with the Thai Revenue Department to finalize the tax structure for REITs.

High Hopes for Thailand's REIT

The hope is that the new REIT option will attract foreign investment to fuel Thailand's property fund market while maintaining Thailand's high credit ratings. The creation of the REIT will provide another means for financing real estate, thereby reducing the need to rely primarily on Thai banks as a source of long-term capital. Finally, large institutional investors seeking real estate exposure will be able to purchase a diversified product in line with their risk appetite.

With the right blend of tax incentives, strong oversight, and a flexible investment framework, Thailand may begin to see growth rates in REITs nearing levels in other parts of Asia, such as Japan, South Korea, and Singapore. Given that China is in the process of formulating its own REIT law and the Philippines has already enacted the Philippines REIT Act of 2009, Thailand would benefit from implementing the new REIT Framework as quickly as possible to maximize its competitive position vis-à-vis other Asian countries.

REITs are expected to drive continued growth in the Thailand real estate market. At the very least, the REIT Framework is a significant upgrade from the PFPO system and represents an important step in the evolution of Thailand's capital market and financing system.

