Bangkok Post The world's window on Thailand

CORPORATE COUNSELLOR

Real estate investment trusts in thailand

Published: 13/12/2013 at 02:12 AM
Newspaper section: Business

The evolution of real property financing in Thailand _ from primarily bank loans to rigid property funds to the proposed real estate investment trusts (REITs) _ reflects the liberalisation of the Thai market, the need for alternative funding options, and the need for the country to maintain its regional competitiveness.

The Capital Market Supervisory Board under the Securities and Exchange Commission (SEC) issued regulations last year governing the issuance and offering of REITs in Thailand. The regulations took effect on Jan 1 this year.

Development of REITs: In the past, Thailand's commercial real estate market was funded primarily by bank loans, secondary offerings and initial public offerings, and to a limited extent, private equity. Previous attempts to broaden financing options through the Property Fund for Public Offering (PFPO) channel proved to be ineffectual and unpopular due to its many restrictions.

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 the 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 the property sector from 2003 onward.

Recognising the limitations of PFPOs, the SEC approved the new regulatory framework for establishing REITs in 2010 and has since followed up by issuing the regulations now in effect.

REIT regulations: The new REIT regulations are expected to provide a modernised vehicle for financing real estate investments, while also providing the flexibility that has made the funds popular at the international level. Additionally, REITs will likely replace existing PFPOs altogether. Establishing a new PFPO or increasing registered capital in an existing one has not been possible during the one-year period following the issuance of REIT regulations.

Converting an existing property fund to a REIT, however, will be possible. The grace period for the existing property funds to raise funds and borrow for investment expansion is effective until the end of 2013, but as the launch of the REITs seems to have run behind schedule, the deadline is likely to be extended.

The REIT regulations contemplate a trust fund structure (not a juristic structure as in existing property funds), whereby the trustee will have the legal right over the fund in terms of ownership and/or properties. Trust certificates will be listed on the Stock Exchange of Thailand. Thus, when forming and operating a REIT, one will need to take into account existing SEC rules regarding, for example, investment in properties, corporate governance, and management restrictions. REIT managers (which can be companies) will manage the REITs, for which they will be required to hold licences issued by the SEC.

Other features of the REIT regulations will ease the limitations seen in the old property fund rules, including the following:

- A REIT can leverage up to 35% of its net asset value (NAV) of assets and up to 60% of its NAV for credit rating of investment grade, whereas the current property fund regulations allow only for leveraging 10% of the NAV.

- The holding restriction for affiliated companies will be increased to 50% of the total trust certificates sold, up from one-third under the PFPO regulations.

- REITs will be permitted to invest in a broad spectrum of real property types, and barred only from investing in immoral or illegal businesses, while a PFPO is permitted to invest only in certain types of real estate projects.The SEC and the Revenue Department are now finalising the tax structure for REITs.

High hopes for Thailand's REITs: The hope is that the new REIT option will attract foreign investment to fuel Thailand's property fund market while maintaining the country's 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 the levels seen in other parts of Asia such as Japan, South Korea, and Singapore.

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

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