



Some conjectures on the REIT market in China

The comments by Premier Wen Jia-bao in the General Meeting of the State Council held on December 3 on financial innovation, including REIT, have elevated market expectation that the introduction of REIT is about to get the green light. The REIT market is generally expected to give a lift to the real estate investment market as well as the stock market. While the devil is always in the details, we have the following conjectures at this juncture:

- Ø The REIT is likely to be more popular for office, commercial and industrial properties than residential properties, given the relatively higher yields of the former in China. En-block ownership of commercial properties with stable income stream are more likely to be packaged for REIT issue, given that a single management could better facilitate enhancement of value of the properties and revamp of tenant mix to raise the rental.
- Ø Large developers or state-owned enterprises holding income-producing real estate assets would likely be the first participants, given the substantial size of asset pool required for listing in the public domain. The REIT market would also provide a convenient channel for the State-owned Assets Supervision and Administration Commission (SASAC) to dispose real estate assets of state-owned enterprises (SOE) in the process of divestment in SOE reform.
- Ø The REIT market provides an alternative channel for foreign investors, including real estate funds, to dispose of their investment apart from traditional asset sale. The availability of an alternative exit mechanism would enhance the attractiveness of property acquisition in China to foreign investors, and hence is expected to boost the investment sales market. This would be even more lucrative if the regulations provide for the establishment of private REITs to provide for smaller property portfolios which do not reach the scale of listing in the stock market.
- Ø While the REIT market enables property investors, including individual investors, to be a stakeholder in a larger property portfolio of which direct acquisition is difficult or out of reach, whether the REIT caters for investors' appetite would depend on a bundle of factors, notably the regulatory framework and evolving developments of the property market. Among which, the following would have bearings on the success of the REIT:
 - (i) the types and quality of assets injected by the developers / owners into the REITs. In particular, the institutional investors would likely balance the benefits of the options of investing in the REIT and direct investment in the underlying assets of the REIT;
 - (ii) asset and gearing restrictions and more generally the capital structure of the REIT;



- (iii) whether tax incentives, such as dividend tax exemption, are offered to REIT beneficiary;
- (iv) the yield differential with other financial products in the capital market, particularly after taking into account the administrative cost, notably management fee, embraced in the REIT; and
- (v) more importantly, the property market outlook, which would be the key determinant on rental income growth and hence distribution per unit (DPU) of the REIT. In this regard, the current consolidation of the property market, particularly the falling rental in the Grade A office market, may pose some downside to the rolling out of the REIT market.

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