



by Joseph Wong

THE Securities Commission's (SC) consultation paper seeking public feedback on proposed enhancements to the Real Estate Investment Trust (REIT) Guidelines has sent

ripples through the investing community.

The 24-page document released on July 14 has 38 questions for the public. It comes on the heels of the recent waiver to Sunway Real Estate Investment Trust that will allow it to acquire land to construct an extension to the Sunway Carnival mall in Seberang Perai, Penang.

According to the SC, the proposals are part of efforts to facilitate growth of the maturing REITs market in a manner that promotes stronger governance practices and greater market confidence.

However, this potentially opens a can of worms as there are a multitude of areas that need to be clearly addressed. After all, not every REIT has the construction capacity and expertise that Sunway REIT has.

ExaStrata Solutions Sdn Bhd chief real estate consultant Adzman Shah Mohd Ariffin points out the move will give REITs a wider range of asset classes to invest in but that it is vital to have greater transparency to allay the fears of the investing public.

"It is different if REITs purchase established buildings or assets that are already yielding income. There's less risk in that. Assets like these can generate income quickly," he tells *FocusM*.

Heightened risk

While acquiring land gives REITs the opportunity of getting growth income as in the case of Sunway REIT, the move carries a higher risk, says Adzman Shah, a former CEO of a REIT.

He says there's no guarantee that the new properties developed on

The Securities Commission's proposed enhancements to the REIT Guidelines are sending ripples through the investing community

With opportunities come risks

If REITs can buy and develop land, they can optimise capital growth but will the properties developed be successful as income-generating assets?

the acquired land will be successful and expand the REIT's portfolio of income-generating real estate. "There's also a development phase of two to four years when there's no income," he adds.

Adzman Shah also raises the question of how the projects will be financed as well as how dividends will be affected by the acquisition of land.

REITs have funds in the form of "money sunk in" by investors, he says, adding if a loan is taken for the acquisition, there would be interest to service.

It's what the industry wants

"There are many questions arising from this move. Among them are how investors' interests are taken into consideration," he says.

The amount involved is not small, given that Malaysian REITs (M-REITs) have a market capitalisation of RM41.07 bil as of June 30.

The market is represented by 17 REITs, including four Islamic REITs, and one which is part of a stapled structure. M-REITs own a wide range of real estate, including office buildings, retail malls, hotels, healthcare establishments and industrial properties.

However, some analysts see the proposed move as a positive one. Tan Han Nee, RAM Rating Services Bhd's manager for structured finance ratings, says from an industry perspective, it is as positive development.

"This is what the REIT industry players [Malaysian REIT Managers Association] have been lobbying for some time now, and this, no doubt, will be much welcomed by them.

"In the current economic and



SHARIL AMIN ABDUL RAHMAN/FocusM

There's a higher risk in acquiring land and developing property than to buy established buildings, says Adzman Shah

property market climate, we expect to see renewed momentum in the REIT industry, although less so from the smaller REITs that have limited debt headroom," says Tan.

This will provide M-REITs with greater latitude in terms of asset allocation in a bid to maintain and enhance yield and capital growth, particularly in a climate of low yields and limited acquisition prospects, she says.

"It would also help to bring local players to a more level playing field with regional REITs which are not fully prohibited from undertaking property development. That said, the added flexibility for M-REITs will be moderated by their increased risk profile given the additional market risks, execution, construction and cost overrun risks," says Tan.

"The extent of the impact ultimately depends on the timing of the completion against economic conditions and the prudence of the REIT managers in studying the feasibility, managing the projects and allocating their resources."

However, Tan does not expect the REITs to take advantage of the liberalisation to trade and speculate on capital value, but more to enable their capital to be used earlier in the development cycles for better capital cost savings. This will in turn optimise capital returns over the long-term.

Crucial safeguards

As land acquisition and property development costs are substantial, to the tune of millions of ringgit, it is not surprising the investing public is jittery but there are safeguards. One of the key aspects of the proposal is to allow REITs to acquire vacant land and undertake property development subject to a cap of 15% of their total asset value, notes an analyst.

The SC also proposes that the threshold on minimum investments in real estate and/or single-purpose companies be increased from the current 50% of a REIT's total asset value to 75%, he says.

This means a REIT's minimum investment in real estate and/or single-purpose companies must be at least 75% of its total asset value at all times.

"This is to ensure that REITs have a substantial portion of their investments in income-generating real estate," the investor says, adding that this would

It would also help to bring local players to a more level playing field with regional REITs which are not fully prohibited from undertaking property development.

- Tan

"We believe that REITs with sponsors that have a background in construction activities such as Sunway REIT, Pavilion REIT and Axis REIT may be in a better position to manage these risks. Those with a more diversified portfolio and resilient earnings should also better afford the earnings volatility in the interim," says Tan.

The progressive nature of construction billings, she explains, could help to stagger the cash-flow impact on the REIT whereas the 15% cap will limit the risk from development activities.

"Furthermore, the SC's proposal to apply a hard cap of 50% on the REIT's leverage limit should also help to minimise escalating financing costs to fund the acquisition of vacant land and development works," she says.

Ultimately, how all of this affects the future of REITs remains to be seen. Until the SC gives the green light, the investing public still has the opportunity to speak its mind. [FocusM](#)

