# Chapter 16
# Turkish REICs: Real Estate Investment or Real Estate Development Companies?

**Dilek Pekdemir**

## Abbreviations

| | |
|---|---|
| CMBT | Capital Market Board of Turkey (*SPK*) |
| IREICs | Infrastructure Real Estate Development Companies (*Altyapı Gayrimenkul Yatırım Ortaklıkları*) |
| ISE | Istanbul Stock Exchange (*İMKB*) |
| REICs | Real Estate Development Companies (*Gayrimenkul Yatırım Ortaklığı*) |

## 16.1 Background

REICs have played an important role in the institutionalisation of the Turkish real estate market. They have promoted legalisation of the real estate industry. The legal framework makes REICs more transparent by providing reliable and quality information. Furthermore, their structure brought international standards and professionalism to the broader real estate industry and fostered foreign investments in Turkey, especially on an institutional scale (Erol and Tırtıroglu 2008).

REITs are key investment tools, in order to bring savings of both individual and corporate investors into a common pool to be used in the resource-starved industry. REITs also offer an alternative to direct-asset investment for investors as well as eliminating the liquidity problem, which is the most fundamental challenge facing investment in the real estate industry (Aktan and Ozturk 2009; Kıyılar and Hepşen 2010). Turkish REITs present an alternative investment vehicle for both individual and institutional investors.

REITs were introduced as a capital market institution in Turkey several years ahead of many developed countries, including Germany, France, UK, Japan,

D. Pekdemir (✉)
Cushman&Wakefield Turkey, Istanbul, Turkey
e-mail: pekdemird@gmail.com

R. Sotelo and S. McGreal (eds.), *Real Estate Investment Trusts in Europe*,
DOI 10.1007/978-3-642-36856-1_16, 

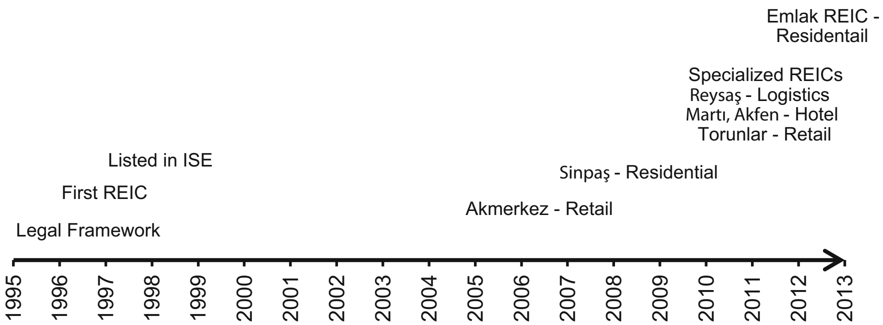


**Fig. 16.1** Historical background of Turkish REICs

Singapore and Hong Kong. The legal framework for Turkish Real Estate Investment Companies (REICs) – *Gayrimenkul Yatırım Ortaklıkları (GYO)* – was prepared by the Capital Markets Board of Turkey (CMBT) in 1995. The first REIC was established in 1996 and REICs became publicly listed on the İstanbul Stock Exchange (ISE) starting from 1997.

The Turkish economy went through a severe restructuring after the financial crisis in 2001, and reached a remarkable growth performance with an average annual growth of 5.5 % between 2004and 2011, supported by the EU accession process. The Turkish real estate market has entered an upward trend, especially from 2004 onwards, following political stabilization, economic improvements and declining interest rates. As illustrated in Fig. 16.1, the number of REICs increased in line with these developments, and their portfolios specialized in certain sectors, as well.

Based on the number of REIC IPOs, the market can be divided into three phases (Fig. 16.2). The first "hot" market occurred between 1997 and 1999 when eight REICs entered the market. The period from 2000 to 2006, when very few REICs came to the market, could be classified as a "cold" market, and was then followed by a new "hot" market from 2007 onward (Arslanlı et al. 2011). The specialized REICs occurred in the later hot period, particularly in 2010.

Turkish REICs have growth potential, although total REIC market capitalization is relatively small with a share of 3 % of total stock market capitalisation, compared with REITs in developed capital markets. As of the end of 2012Q3, 24 REICs were listed on the ISE with a total net asset value of USD 7.48 billion, while market capitalization was USD 12.59 billion.

Twenty-four REICs were listed on the ISE, by the end of 2012. Three REICs started to be traded on the ISE in the first quarter of 2013, while four new REICs have been authorized for public offering, and their shares are expected to be traded on the ISE in the years ahead.

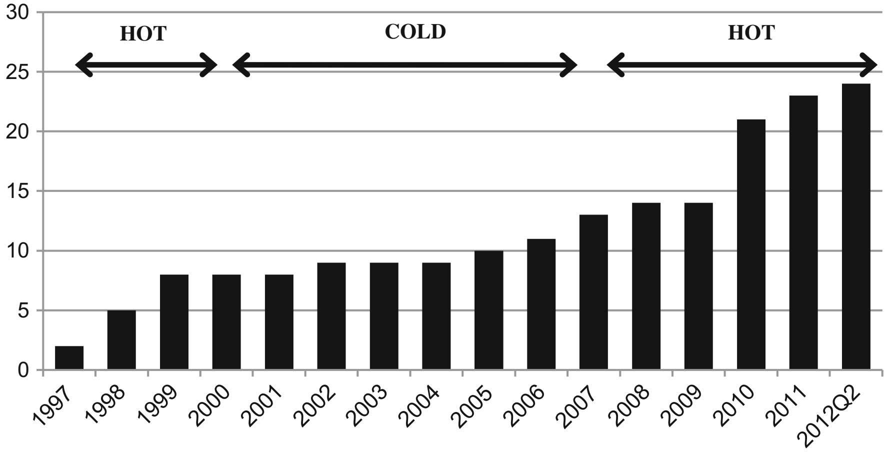


**Fig. 16.2** Development of Turkish REICs (Data compiled from CMBT)

## 16.2 Regulations

The REIC regime is regulated by Capital Market Law and in the related Communiqué (Principles regarding REICs Serial VI, No.11). The regulations took place initially with the modification of the Capital Market Law in 1992, and then detailed arrangement was made in the related Communiqué in 1995.

Turkish Real Estate Investment Companies are established in the form of joint-stock corporations and they are legal entities. They don't have a trust status and are not managed by a board of trustees (EPRA 2012).

REICs may be constituted by establishing new joint stock companies, or existing joint stock companies can convert into REICs by amending their articles of association in accordance with the procedures of the Communiqué and Capital Market Law. For either the establishment or the conversion of a company into an REIC, CMBT approval must be obtained. The company's name must include "real estate investment company".

REICs are required to float at least 25 % of their shares to the public. REICs are obligated to apply to CMBT for offering share certificates representing 25 % of their capital to the public within 3 months after establishment. There are no restrictions on foreign shareholders.

A REIC can be established for a specific period to realize a certain project, for a specific or unlimited period to invest in certain areas and for a specific or unlimited period without any limitation of objectives.

Like REITs around the world, Turkish REICs must deal primarily with portfolio management. The portfolio of a general purpose REIC is required to be diversified based on industry, region and real estate and to be managed with a long-term investment purpose. In case a REIC is established with the purpose of operating in certain areas or investing in certain projects, at least 75 % of the REIC's portfolio must consist of assets mentioned in its title and/or articles of association.

REIC's are required to invest in real estate, rights supported by real estate and real estate projects at a minimum rate of 50 % of their portfolio values. They can invest in time deposit and demand deposits in TRY or any foreign currency for investment purposes at a maximum rate of 10 % of their portfolio values. Investments in foreign real estate and capital market instruments may only constitute no more than 49 % of the REICs portfolio value.

Any vacant land and lots in the portfolio of the REIC, on which any project has not been realized for 5 years as of the acquisition date, should not exceed 10 % of its portfolio value.

In order to meet the short-term fund demands or costs related to the portfolio, a REIC can obtain credit at a rate of five times the net asset value. A REIC can issue debt instruments within the restrictions of the capital market legislation.

There are restrictions on the activities of REICs; they cannot be involved in the construction of real estate as a contractor. Additionally, they cannot commercially operate any hotel, hospital, shopping centre, business centre, commercial parks, commercial warehouses, residential sites, supermarkets and similar types of real estate nor can they employ any personnel for this purpose. If any real estate exists in the portfolio for the purpose of generating rental revenue, companies can provide the security, cleaning, general management and similar services to tenants for such real estates.

In order to promote the growth of the Turkish REIC industry, significant tax incentives have been granted to REICs. Profits generated from the portfolio management activities of REICs are exempt from the general applicable 20 % corporate tax. In addition, although an official exemption has not been granted, the income tax rate has been determined to be "zero" for REICs. Aside from these two incentives, REICs are subject to all other applicable taxes, such as VAT, title deed fee, except stamp duty.

An important difference of Turkish REICs from other REITs in more developed economies is that Turkish REICs do not have to pay out dividends to the shareholders on an annual basis.

The profit distributions of REICs are subject to the general regulations of the CMBT with respect to the timing, procedures and limits of profit distributions of public companies. According to the communiqués regarding dividend distributions, public companies are required to distribute at least 20 % of their annual profits after the deduction of tax provisions, legal reserves and accumulated losses.

However, based on the Communiqué public companies may freely decide to distribute dividends; (1) entirely in cash, (2) entirely as shares, (3) partially in cash and partially as shares and keep the remaining as reserves, (4) keep all the profits as reserves.

A dividend withholding tax rate of 15 % is applicable to dividends distributed to individual and foreign corporate shareholders. For REICs however, the Council of Ministers has determined a withholding tax rate of 0 %, therefore dividend distributions to individual and non-resident shareholders of REICs create no dividend withholding tax burden.

The CMBT announced another type of CMBT-regulated company as Infrastructure Real Estate Investment Companies (IREIC) in the beginning of 2009. IREICs are closed-end, corporate tax exempt, investment companies managing portfolios composed of properties, companies, projects and capital market instruments based on infrastructure investments and services, and other capital market instruments.

As a capital market instrument, IREICs will help securitization and will provide transparency in the market. Although no IREIC has been established yet, this framework can be considering as an embryonic stage for infrastructure REITs in Turkey and will be an alternative asset class for investors (Pekdemir 2010).

## 16.3 Asset Allocation of Turkish REICs

There is a requirement that Turkish REICs are diversified based on industry, region and real estate and to be managed with a long-term investment purpose. REICs can engage in the following activities:

- Investing in real estate
- Investing in real-estate backed securities
- Generating rental income from their portfolios
- Real estate sales
- Purchase land to realise capital gains or to develop projects.

The proportion of property assets in their portfolio changes depending on Turkish economic conditions. During the recession period in the late 1990s, the REICs preferred to maintain liquid portfolios and took advantage of the high real interest rates in those years. Following the economic recovery, new development projects have been started and the share of property assets increased gradually. The first wave of "project development oriented" REICs adopted "develop-hold" strategies and developed their assets, mainly due to the lack of investment grade products in Turkey. On the other hand, the second wave of "project development oriented" REICs adopted "develop-sell" strategies and focused on "developer's profit" instead of "rental income & capital gain" (Fig. 16.3).

In the early stages of their development, the core business area of the major shareholders was either banking (Garanti, İş, Vakıf, Yapı Kredi Koray) or the construction/development business (Alarko, Yeşil, Nurol). Later, REICs became specialized in certain markets, especially since 2010 (Pekdemir and Soyuer 2012; DTZ Pamir & Soyuer 2007, 2012):

- Retail (Akmerkez 2005; Torunlar 2010)
- Residential (Sinpaş 2007; İdealist 2010; Emlak Konut 2010)
- Logistics (Reysaş 2010)
- Hotel (Martı 2010; Akfen 2011)

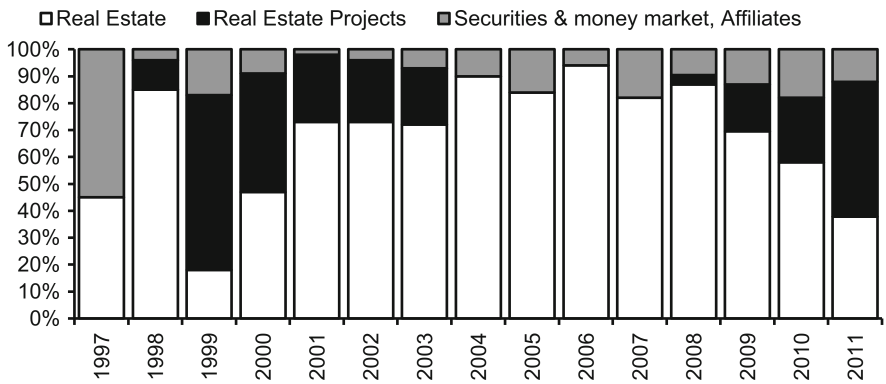


**Fig. 16.3** Portfolio composition of Turkish REICs (CMBT 2013)

The REICs portfolio composition, which came on the market in different stages, displays a notable difference (Fig. 16.4). The REICs that first entered the market in the early stages, following introduction of the Communiqué, were more evenly spread across the traditional real estate sectors than the REICs that came later. In contrast, the later REICs in comparison are much more diverse, with relatively large holdings in hotels, logistics and warehouse properties as well as in the traditional sectors, with very few interests in securities (Arslanlı et al. 2011).

Another difference in Turkish REICs' portfolio composition is the significant increase of land and development projects in the total asset value. Compared with the earlier stages, their share increased almost twofold in the latest stage. In the first half of 2000s, the share of land and development projects was around 15–30 % in total asset value while the market dominated by REICs with large commercial portfolios represented around 55–70 % of total asset value. By the end of 2010, almost 50 % of the total portfolio was composed of land and development projects, while only 14 % of the total portfolio was invested in commercial assets.

As of the second quarter of 2012, land and development projects have the major shares with 25 % and 21 % in total asset value, respectively, followed by retail, residential and office properties with shares of 16 %, 9 % and 5 %. Newer sectors, such as hotel and logistics properties have only 3 % and 2 %, respectively (Fig. 16.5).

The current asset composition of Turkish REICs emphasizes development of their own assets, due to the lack of investment grade property portfolios in Turkey. REICs have become a "developer's vehicle" for construction companies and contractors. They act like "developer" instead of "investor" and also focus on "developer's profit" instead of "rental income and capital gains". Their behaviour indicates the unique characteristics of Turkish REICs, and therefore may called "Real Estate Development Companies – REDCs".

Turkish REICs can be categorized into three types by investor type, investment product and strategy, as given in the Table 16.1 and Fig. 16.6:

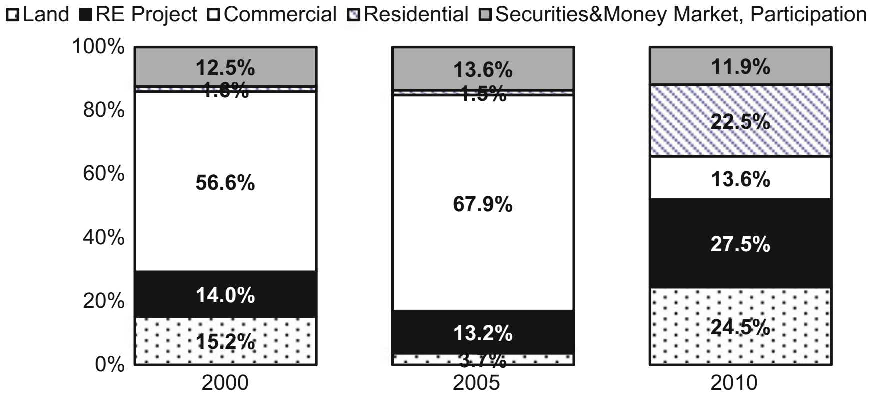


**Fig. 16.4** Asset allocation of Turkish REICs in different stages (Pekdemir and Soyuer 2012)

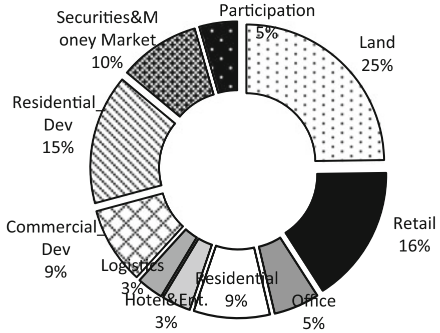


**Fig. 16.5** Turkish REICs asset allocation (CMBT 2013)

**Table 16.1** Turkish REICs characteristics (Pekdemir and Soyuer 2012)

| Characteristics | Type I | Type II | Type III |
|---|---|---|---|
| Investor type | Investor | Developer/investor | Developer |
| Investment strategy | Buy/hold | Develop/hold | Develop/sell |
| Investment product | Income producing assets | Income producing assets | Residential sales |
| REICs | Akmerkez | İş | Emlak Konut, Sinpaş |

Type I and Type II REICs are focused on commercial assets, which are income producing assets. They have conservative strategies and take less risk. In contrast, Type III REICs are focused on residential sales, which force them to apply aggressive strategies with higher risk. The total net asset value and distinctive characteristics of the selected REICs regarded by type are illustrated in Fig. 16.6.

The aforementioned characteristics of Turkish REICs may be attributed to a number of factors.

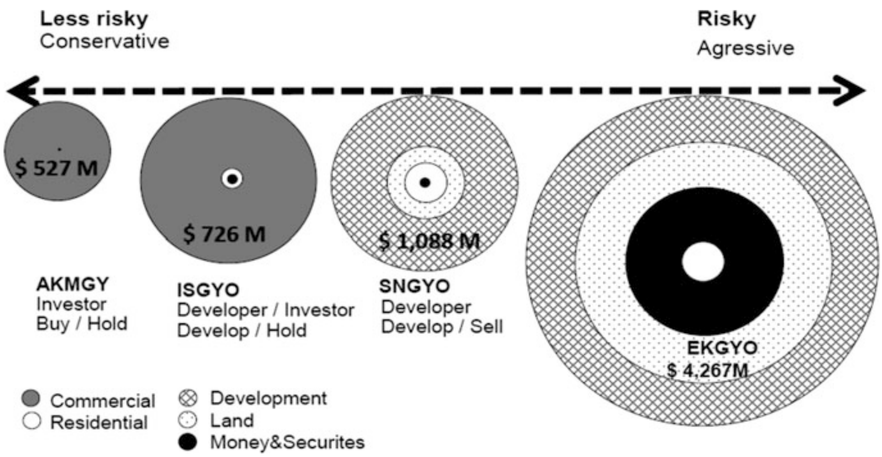


**Fig. 16.6** The selected Turkish REICs characteristics (Pekdemir and Soyuer 2012)

First, the lack of investment grade products has become a chronic problem especially for corporate investors. For this reason, REICs prefer to develop their own assets, which force them to act like a developer instead of like an investor.

The second reason is difficulties in providing financing. Especially, residential assets are able to create a source for financing by the pre-sale of residential units. Thus, a developer / investor can finance the remaining developments or buy land for new projects. It should be noted that as a unique investment characteristic in Turkey, residential assets are considered for their sale instead of as income producing assets, compared with mature markets. No large companies invest in residential portfolios for leasing purposes, because residential properties provide much more return from capital gains and less income yield. Therefore, both individual and corporate investors prefer to take advantage of capital gains by residential sale.

Thirdly, REICs provide tax advantages and especially construction companies can benefit from this advantage.

## 16.4 Performance of Turkish REICs

Between 1996 and 1999, the aggregate net asset value of Turkish REICs increased from USD 50 million to USD 75 million while the aggregate market value increased from USD 55 million to USD 780 million. This was followed by a drop until 2002. The market value decreased to USD 207 million, resulting in approximately 70 % discount to NAV. In line with the tight monetary policy and restructuring implementation following the Turkish banking crisis in 2001, the market started to recover and reached USD 3.3 billion net asset value, until the 2008 global financial crisis. The market returned to the pre-crisis level in 2009; moreover, a huge step occurred in 2010 exceeding USD 11.2 billion net asset value.

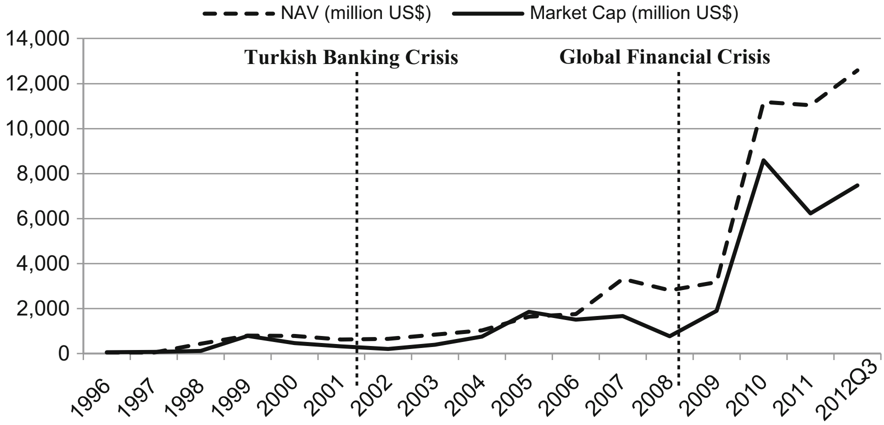


**Fig. 16.7** Historical performance of Turkish REICs (Data is compiled from CMBT)

The historical net asset value and market capitalization of the Turkish REIC market is given in Fig. 16.7.

The gap between the total NAV and market capitalization of the REIC market increased significantly after 2010. As explained in the previous section, this can be attributed to the changing strategies of the large REICs which implement "develop/sell" strategies and focus on residential sales. Most notably, the entrance of Emlak Konut REIC, representing almost half of the total market NAV, changed the balance in the market. The government-oriented structure and large share of land and development projects in its portfolio may create a high risk perception in the market.

As of September 2012, the 24 listed REICs' total net asset value reached a level of USD 12.59 billion while market capitalization was only USD 7.48 billion. Emlak REIC is the industry leader both in terms of net asset value and market capitalization with a share of 46.2 % of total market capitalization. The second largest REIC, Torunlar has a share of 10.5 % of the total market capitalization, followed by Sinpaş with a share of 5.7 %. The largest three REICs represent approximately 62 % of both total NAV and market capitalization. Market capitalization and net asset value of REICs are given in Table 16.2.

As illustrated in Fig. 16.8, REICs are traded at a discounted value on the stock exchange. Possible causes of the discount may be the high ratio of land and development assets which creates a high risk perception in their portfolios and/or a low dividend payout ratio.

The return of Turkish REICs has displayed volatile performance throughout the different stages of its development (Fig. 16.9). After the enactment of the legislation, REICs were a new and untested vehicle by investors, which suggests high information asymmetry between the REICs and investors, which led to relatively high return performance in the earlier stage. Then, a strong fall in return followed, partly due to the Turkish banking crisis in 2001. The following stage was dominated

**Table 16.2** Market capitalization and NAV, 2012Q3 (CMBT September 2012)

| REIC | NAV (million USD) | Market cap (million USD) | Premium/discount (%) |
|---|---|---|---|
| AKFEN | 611.3 | 164.3 | −73.1 |
| AKMERKEZ | 527.1 | 384.4 | −27.1 |
| ALARKO | 128.1 | 110.4 | −13.8 |
| ATAKULE | 126.6 | 54.8 | −56.7 |
| AVRASYA | 44.8 | 22.5 | −49.8 |
| DOĞUŞ-GE | 110.9 | 82.7 | −25.5 |
| EGS | 75.8 | 6.1 | −91.9 |
| EMLAK KONUT | 4,266.5 | 3,459.3 | −18.9 |
| İDEALİST | 5.2 | 16.2 | 213.4 |
| İŞ | 725.7 | 448.6 | −38.2 |
| KİLER | 265.3 | 121.1 | −54.4 |
| MARTI | 119.9 | 32.5 | −72.9 |
| NUROL | 276.5 | 184.6 | −33.3 |
| ÖZAK | 450.5 | 197.1 | −56.2 |
| ÖZDERİCİ | 72.9 | 42.4 | −41.8 |
| PERA | 122.4 | 27.9 | −77.3 |
| REYSAŞ | 245.7 | 79.6 | −67.6 |
| SAF | 402.9 | 450.2 | 11.7 |
| SİNPAŞ | 1,087.7 | 425.2 | −60.9 |
| TORUNLAR | 2,372.1 | 783.9 | −67.0 |
| TSKB | 193.9 | 57.8 | −70.2 |
| VAKIF | 107.6 | 212.7 | 97.6 |
| YEŞİL | 619.5 | 89.2 | −85.6 |
| YAPI KREDİ KORAY | 62.7 | 28.8 | −54.1 |

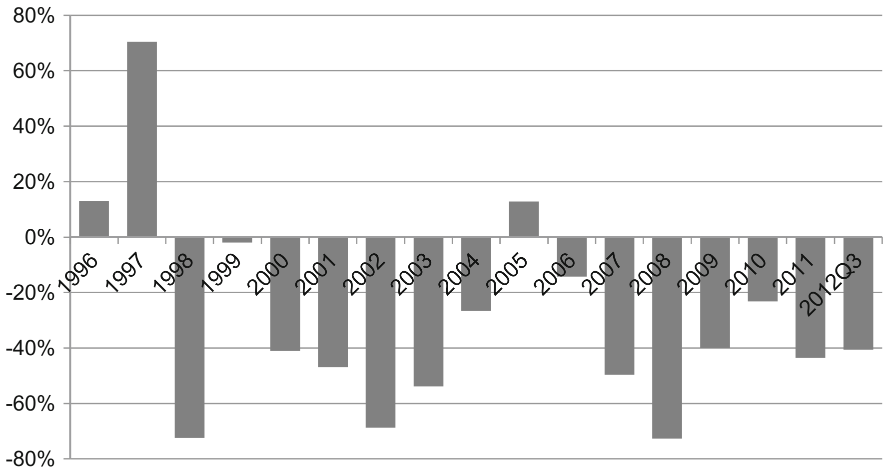


**Fig. 16.8** The premium/discount trend of Turkish REICs (sector average)

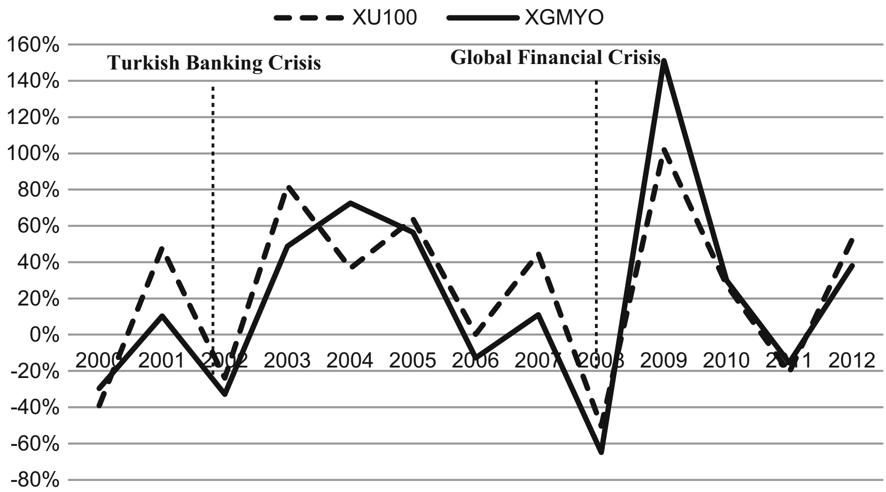


**Fig. 16.9** The annual return performance of Turkish REICs versus Istanbul Stock Exchange (ISE 2013)

by REICs with a large commercial portfolio and implied higher return, followed by a fluctuation in return with the entrance of the specialized REICs. Another strong fall appeared with the negative effect of the global financial crisis in 2008, but was followed by the highest return ever which exceeded stock market returns.

According to the FTSE EPRA/NAREIT Emerging Market Index, eight listed Turkish REICs were included with combined market capitalization of USD 4 billion, as of February 2012 (Zahidi 2012). The EPRA Turkey index posted a 62 % annual growth with a healthy contribution to the EPRA Emerging Markets Index which has been one of the top performing indices with an annual return of 28 % in 2012.

## 16.5 Future Challenges

In the developed markets, REITs are predominantly owners and operators of high-end commercial properties with a little exposure to property development. On the other hand, the Turkish market is in its growth phase and the mix of classic REIT characteristics with added flexibility on development is perhaps the most suitable combination at the current stage (Zahidi 2012).

In fact, the construction sector is one of the engines of the Turkish economy, stimulated by an urbanization rate, population growth, young population ratio and housing demands which have expanded in direct proportion to real estate investment. The new mortgage law, introduced to the market in 2007, and the growing mortgage market will have a positive effect on the future of REICs

The recent regulation on the acquisition of property by foreigners, which allows the purchase of property without reciprocity, made the Turkish market more attractive on an international level. Foreign investors have entered the market not only by purchasing real estate, but also by directly developing projects, establishing partnerships with construction and development companies, and by making portfolio investments in the stock exchange market. Turkish REICs will play a more important role in the near future by attracting equity investment not only by domestic, but also by international investors.

The REIC regime has not only stimulated the listed market but also specialized companies focusing on specific sectors such as logistics, retail and hotels, which is one of the characteristics of a mature market. Developers need to differentiate their products with much more specialized assets. Furthermore, provided that REICs will be more active at investing in income-generating asset classes and will be able to create bigger portfolios, Turkish REICs will be more attractive for investors in the near future.

Investor interest is evident from the growth and IPOs offer good opportunity to reach new investors. The market dynamics have pushed a number of IPOs in the recent years; in addition at least four new REICs are in line for an IPO in the coming 2 years.

Turkish REICs act like developers, due to the lack of investment grade property portfolios in Turkey. Besides, construction companies prefer to be REIC to take tax-advantages. This trend is expected continue in the medium term.

Turkey has a well developed construction sector and experienced contractors, so they should not be limited to REICs, also "Infrastructure REITs" offer good opportunity for them.

## References

Aktan, B., & Ozturk, M. (2009). Empirical examination of REITs in Turkey: An emerging market perspective. *Journal of Property Investment & Finance, 27*(4), 373–403.

Arslanlı, K., Pekdemir, D., & Lee, S. (2011, June 15–18). *Initial return performance of Turkish REIT IPOs*. Paper presented at the 18th ERES Conference, Eindhoven.

Capital Market Board of Turkey. (2013). http://www.spk.gov.tr. Accessed 2 Apr 2013.

DTZ Pamir & Soyuer. (2007). *Turkey REICs*.

DTZ Pamir & Soyuer. (2012). Property Times Q32012.

EPRA. (2012). *Global REIT survey 2012: Turkey REICs*. http://www.epra.org. Accessed 25 Mar 2013.

Erol, I., & Tırtıroglu, D. (2008). The inflation-hedging properties of Turkish REITs. *Applied Economics, 40*, 2671–2696.

Istanbul Stock Exchange. (2013). http://www.ise.org. Accessed 2 Apr 2013.

Kıyılar, M., & Hepşen, A. (2010). Performance appraisal of real estate investment trusts (REITs): A practice in ISE. *Yönetim, 21*(65), 11–23.

Pekdemir, D. (2010, June 23–26). *Early stage of infrastructure REITs: Turkey experience at legislative level*. Paper presented at the 17th ERES Conference, Milan.

Pekdemir, D., & Soyuer, F. (2012, June 15–18). *Turkish REICs or REDCs: Analysis of the effect of asset allocation on return*. Paper presented at the 19th ERES Conference, Edinburgh.

Zahidi, A. (2012). Turkey's maturing listed market. *Turkey Real Estate Yearbook, 2012*, 38–39.