Chapter 7
Asian REITS: Growing into Maturity

Joseph T.L. Ooi and Woei-Chyuan Wong

7.1 Overview

The Asian REIT markets have grown substantially over the past decade, partly due to a boom in the number of REIT IPOs and partly due to the newly listed REITs expanding aggressively by acquiring many properties within a short time period, often funded by cheap debt. Investors' appetite is boosted by the positive risk-adjusted returns registered in the four major REIT markets in Asia, namely Japan, Singapore, Hong Kong and Malaysia.

The onset of the global financial crisis (GFC), however, stalled the growth momentum. Faced with falling property values, shrinking market capitalization, overleveraging and refinancing risk, several REITs in Asia were delisted or needed bailing out. The GFC experience underscores the vulnerability of REITs to tight credit markets because they do not hold any financial reserves as well as the importance of maintaining a prudent balance sheet and a proactive debt capital management strategy.

In addition to addressing the above issues, this chapter introduces an initiative by the Asia Pacific Real Estate Association (APREA) to create a corporate governance scoring framework for externally managed REITs in Asia. In terms of corporate governance, Asian REITs are somewhat green fields due to the fact that almost all the REITs listed in Asia are externally managed. This, coupled with the fact that they are often tightly held by their sponsors, generates a myriad of agency problems, among which fees and related party transactions are paramount.

J.T.L. Ooi (✉)
Department of Real Estate, National University of Singapore, Singapore, Singapore
e-mail: rstooitl@nus.edu.sg

W.-C. Wong
College of Business, University Utara Malaysia, Sintok, Kedah, Malaysia

R. Sotelo and S. McGreal (eds.), *Real Estate Investment Trusts in Europe*,
DOI 10.1007/978-3-642-36856-1_7,

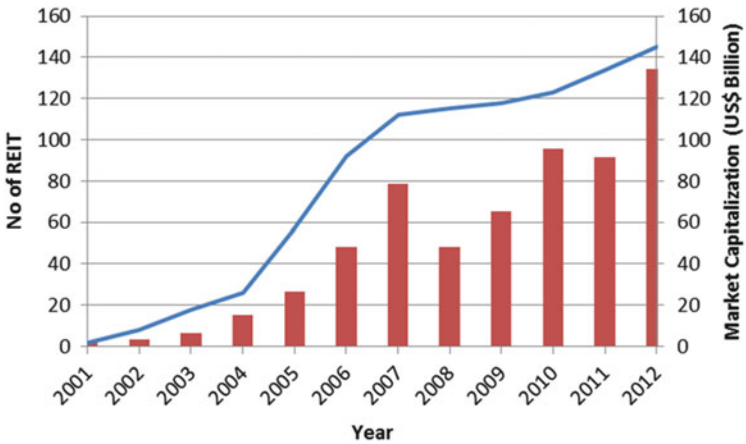

Fig. 7.1 Growth of REITs listed in Asia. The *blue line* tracks the number of listed REITs in Asia from 2001 to 2012, while the *vertical bars* mark their total market capitalization in corresponding period

7.2 Background

Modern real estate investment trusts (REITs) emerged in Asia with two REITs launched simultaneously in Japan in September 2001. Soon after, South Korea and Singapore saw their maiden REITs in 2002. Hong Kong, Malaysia, Taiwan and Thailand subsequently joined the REIT bandwagon in Asia.[1] Figure 7.1 tracks the dramatic growth of the REIT market in Asia between 2001 and 2012. During the 12-year period, total market capitalization of Asian REITs grew from US$1.7 billion to US$134.5 billion. Correspondingly, the number of Asian REITs grew from 2 to 145.

As of December 2012, there were 145 REITs listed in Asia. Table 7.1 provides a snapshot of the relative size of the respective markets. The four largest markets in Asia are Japan, Singapore, Hong Kong and Malaysia. Together, the REITs in these four markets account for 93 % of market capitalization of all Asia REITs. Japan has 37 listed REITs with a combined market capitalization of US$52.2 billion. This is followed by Singapore, which has 28 listed REITs with a total market capitalization of US$43.2 billion. The REIT sector in Hong Kong (HK_REIT) is still underdeveloped as compared to those in Singapore and Japan. It accounted for less than 6 % of total listed property market capitalization in Hong Kong (CBRE 2011). Nevertheless, the potential of REITs in Hong Kong is huge given its role as an offshore center for real estate owners from mainland China. In Malaysia, the increasing appetite for the securitized property investments has led many property owners to

[1] See Ooi et al. (2006) for a discussion on the major driving forces in the growth and development of REIT markets in Asia.

Table 7.1 REIT markets in Asia

Market	Listing date of maiden REIT	Number of REITs	Market capitalization (US$) @ Dec 2012
Japan	Sep 2001	**37**	**52.2**
Singapore	Jul 2002	**28**	**43.2**
Hong Kong	Nov 2005	**9**	**22.2**
Malaysia	Aug 2005	**16**	**8.0**
Thailand	Oct 2003	**41**	**6.1**
Taiwan	Mar 2005	**6**	**2.6**
South Korea	Jan 2002	**8**	**0.2**
Total		**145**	**134.5**

join the REIT bandwagon. Recent listing of IPOs such as Sunway REITs (2010), CapitaMall Malaysia Trusts (2010), Pavilion REIT (2011) and IGB REIT (2012), each with asset base of more than US$1 billion, have escalated the market capitalization of Malaysia REITs (M-REITs).

Due to their restrictive guidelines, the REIT markets in Taiwan, Thailand and South Korea have not grown as much. In particular, the growth prospects of Taiwan REITs are restricted because they are not allowed to offer secondary offerings even if they have good investment opportunities. Similarly, REITs in Thailand have limited growth opportunities because REITs here are passively managed with rigid gearing limit (not more 10 % of their net asset value). Not much vibrancy is found in South Korean market because the REIT market here is populated by corporate restructuring REITs (CR-REITs) which are recession centric instruments that allow investors to participate in real estate held by corporate and financial institutions for a finite holding period.

In contrast, Singapore has developed into a REIT hub in Asia due to its openness and its progressive REIT regime. While most REIT markets in Asia focused on domestic properties, a distinguishing factor of the Singapore REIT market is that many of the Singapore REITs (S-REITs) invest and own cross-border properties. As documented by J. P Morgan (2012), 29 % of the asset under management (AUM) of S-REITs is in overseas assets. This figure could increase to 40 % in the long run. Currently, nine S-REITs are holding pure overseas properties. For example, Fortune REIT, Perennial REIT, CapitalRetail China Trust and Mapletree Greater China Commercial Trust own and operate shopping centres and commercial properties in Hong Kong and China, but they are listed in Singapore. Similarly, First REIT and Lippo Mapletree Indonesia Retail Trust own healthcare properties and shopping malls, respectively in Indonesia, while Ascendas India Trust and Indiabulls Properties Investment Trust own properties in India. Other examples include: Saizen REIT which owns properties in Japan, Keppel REIT owns three commercial properties in Australia, Parkway Life owns healthcare properties in Malaysia and Japan, and Ascott Residence Trust owns properties in Asia Pacific, Europe and the United Kingdom.

In addition, a few S-REITs which started off as purely domestic focused have broadened their investment scope to include overseas properties. For example, Ascendas REIT which focused primarily on industrial premises in Singapore acquired its first overseas property in Shanghai in 2011. In contrast, none of the Japan REITs (J-REITs) have yet to pursue a similar strategy despite being eligible to acquire assets outside Japan since 2008. According to C. B. Richard Ellis (2012), J-REITs' lack of activity abroad is due partly to the fact that requirements on the appraisal of overseas properties owned by J-REITs are ambiguous.

The phenomenal growth experience in Asia can be attributed to a boom in the number of new REITs being listed, as shown by the increased in the number of listed REITs in Fig. 7.1, as well as the aggressive acquisition strategy adopted by the newly listed REITs. Motivated by a management fee structure that is tied to the size of the AUM and an additional incentive fee for acquisition of new assets, the managers grew their REITs by aggressively acquiring many properties within a short time period. Examining 228 acquisitions by J-REITs and S-REITs, Ooi et al. (2011) find that the aggressive growth strategy adopted by Asian REITs is not detrimental to shareholder wealth. Analyzing the acquisition sequence of serial acquirers, they find that the stock returns are marginally higher for the first deal announced by individual firms. They also observe that smaller-sized REITs generate positive abnormal returns from their acquisitions. On the whole, the results suggest that REITs will find it harder to earn abnormal returns from acquisitions over time.

Between 2002 and 2006, 284 deals involving US$20.5 billion worth of properties were acquired by J-REITs and S-REITs, which accounted for more than a third of the combined market capitalization of the REITs (Ong et al. 2011). Since REITs have to disburse almost all their earnings to their shareholders, these acquisitions had to be financed through external funding, either in the form of debt, or new equity issues, or both. It should be noted S-REITs face a tighter constraint in their ability to raise debt; in general, they are not allowed to have a debt ratio exceeding 35 % of their total assets, but the debt limit can be raised to 60 % if the S-REIT is rated. J-REITs, on the other hand, do not have any debt limit.

7.3 Refinancing Risk

Table 7.2 reports the risk-adjusted performance of the four main REIT markets in Asia, namely Japan (J-REIT), Singapore (S-REIT), Hong Kong (HK-REIT) and Malaysia (M-REIT). Jensen's alpha (α) measures the average return of the respective REIT markets over and above the return of their corresponding stock markets, after adjusting for risk.[2] In addition reporting to their performance over the full

[2] Jensen's alpha (α) is the estimated intercept from $R_{p,t} - R_{f,t} = \alpha + \beta(R_{m,t} - R_{f,t}) + \varepsilon_p$ where $R_{p,t}$ indicates the monthly return on a portfolio of REIT stocks, $R_{f,t}$ is the monthly return on the risk-free three month Treasury bill, and $R_{m,t}$ is the monthly return on the market portfolio. To explore the performance of REIT stocks in Asia, a value-weighted portfolio of all the REIT stocks in each market is first created.

Table 7.2 Risk-adjusted performance of Asian REITs

	Full periods	Pre-crisis	Crisis	Post-crisis
	(Jan03–Dec12)	(Jan03–Jun07)	(Jul07–Dec08)	(Jan09–Dec12)
J-REIT	0.25 %	1.47 %**	0.20 %	0.38 %
S-REIT	0.87 %*	2.00 %***	−2.06 %	1.77 %**
M-REIT	0.10 %	−0.96 %	−1.44 %**	0.78 %**
HK-REIT	0.68 %	0.77 %	−1.62 %	2.08 %***
Overall	0.47 %*	1.23 %***	−1.50 %*	1.18 %***

***, **, and * indicates significance at the 1 %, 5 %, and 10 % level respectively

period, the performance is decomposed over different sub-periods, primarily to highlight the susceptibility of Asian REITs to the global credit crisis in 2007–2008.

Over the full period, all the four REIT markets registered positive risk-adjusted returns with the best performers being S-REITs and HK-REITs. In other words, REIT stocks performed better than common stocks in their respective markets, after adjusting for risk. Comparing their performance over different periods, Table 7.2 shows that the performance of Asian REITs dropped significantly during the credit crisis, which was indeed a tough period for the REITs. As a result of falling property values and shrinking market capitalization, which reduced by 38.6 % from US $78.72 billion to US$48.37 billion, the gearing of Asian REITs increased from 0.38 to 0.42. In a February 2009 report, the Asian Public Real Estate Association (APREA), a body that represents the listed real estate sector in Asia, estimated that listed property firms and REITs had to refinance an estimated US$12 billion in debt. Even if the REITs could refinance the maturing debts, they would have to pay a higher cost as credit spreads widened significantly during the crisis period. J. P. Morgan (2012) noted that many REITs consequently had to sell assets and or raise new equity capital in order to meet their debt obligations and to deleverage.

REITs that could not raise money to repay their debts had to file for bankruptcy. In October 2008, New City Residence Investment Corporation, which was listed in Japan, filed for court protection from its creditors due to difficulty in raising money to repay its debts. It was not the only J-REIT that got into financial difficulties. Indeed, saddled with overleveraging and refinancing risk, nine J-REITs were eventually delisted (or merged) between 2008 and 2010. They include LCP Investment Corporation, Nippon Residential Investment Corporation, Advance Residence Investment Corporation, LaSalle Japan REIT, New City Residence Investment Corporation, Prospect REIT Investment Corporation, Japan Single-Residence REITs, Nippon Commercial Investment Corporation, and Ichigo Real Estate Investment. Consequently, the total number of J-REITs decreased from 42 in June 2008 to 36 in October 2010 (CFA Institute 2011). Meanwhile, in Singapore, Saizen REIT defaulted on a 7.3 billion yen (US$80.26 million) commercial mortgage backed securities loan on 4 November 2009, while another S-REIT, MacarthurCook Industrial REIT, which was subsequently renamed as AMP Capita Industrial REIT, needed to be bailed out.

The GFC experience underscores the importance of maintaining a healthy balance sheet, not only to provide sufficient headroom for growth, but to reduce refinancing risk. REITs are especially vulnerable to tight credit markets because they do not retain any financial reserves. Thus, a major concern of REITs during the recent credit crunch was the ability to access capital to maintain adequate liquidity and to refinance maturing loans.[3] Moreover, the short-term nature of bank borrowings, which is the primary form of lending in Asia, presents an additional challenge for REITs to manage the asset-liability mismatch. Learning to adopt a more prudent capital management policy, REIT managers now recognize the importance of proactively managing their capital, especially the need to lengthen and spread their debt maturity structure by tapping into alternative sources of funding. Although strengthening banking relationships and securing credit lines could insulate the firms against a credit crisis, such protection may not be available to REITs with low credit rating in the first place (Ooi et al. 2012).[4] The GFC experience also shows that support from a strong sponsor is crucial to weather a financial storm. For instance, sponsors such as Keppel Land and CapitaLand subscribed to new shares issued by their sponsored S-REITs when the credit market dried up.

7.4 Governance of Externally Managed REITs

Asian REITs are somewhat green fields in terms of corporate governance, in part due to the fact that REIT regimes are still relatively new in Asia but also because of their structural idiosyncrasies. With the exception of Link REIT in Hong Kong, all the REITs listed in Asia are externally managed. Figure 7.2 shows the classic structure of an externally managed REIT, taking the legal form of a Trust involving a Sponsor, generally a large real estate company, a Trustee, a Trust Manager and a Property Manager. The externally managed model adopted by Asian REITs generates a myriad of agency problems, among which fees and related party transactions (RPT) are paramount (LeComte and Ooi 2013).

More often than not, the Manager is wholly owned by the Sponsor, who also retains a significant stake in the newly listed REIT. Examining 78 initial public

[3] While many scholars have studies the economic gains associated with new debt issues, the effects of debt refinancing is generally ignored because they do not have any effect on a firm's capital structure. Nevertheless, in a tight credit market, the REIT's ability to secure refinancing conveys a credible signal on its credit worthiness. Examining a sample of 340 debt announcements by J-REITs between 2002 and 2011, Tang et al. (2013) confirm the impact of the credit crisis on debt announcement effects.

[4] In a study on 275 REITs listed in the US between 1992 and 2007, Ooi et al. (2012) find that although bank lines of credit may in theory insulate REITs from credit rationing at both the broad market level as well as the firm level, such protection does not work in practice for REITs with low credit rating.

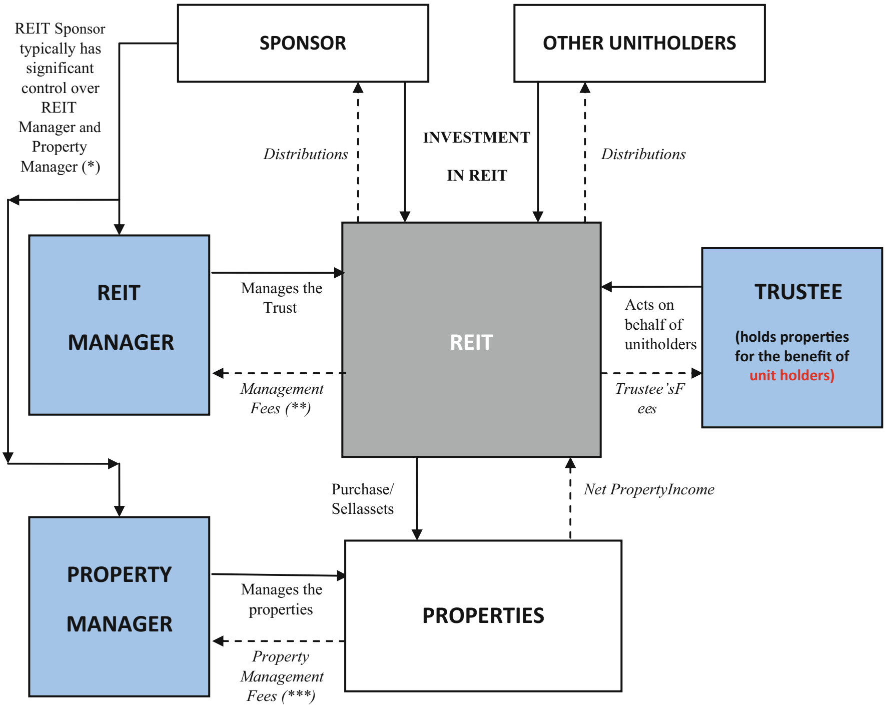

Fig. 7.2 Generic structure of an externally managed-REIT (Source: LeComte and Ooi 2013). (*) The Sponsor has a significant holding in the REIT and usually owns the asset management and property management firms. (**) Management fees include base fee, performance fees and acquisition/divestment fees. (***) Property management fees might include leasing commissions

offerings (IPOs) of Asian REITs between 2001 and 2008, Wong et al. (2013) observe that the sponsors, on average, retained 19 % of the IPO shares. The externally-managed model coupled with the entrenched position of the REIT manager creates a captive situation where minority shareholders' interests are heavily controlled by the sponsor, who also continues to sell its assets and management services to the listed REITs while running its own parallel real estate businesses. This gives rise to potential conflict of interests in terms of staff devotion, favorable treatment of sponsor properties over REIT properties, overpricing of services by the managers as well as cherry picking of properties by the sponsor (RiskMetrics Group 2009).

On average, RPTs amount to 5.4 % of a REIT's total assets. This is nearly double the 2.8 % rate observed for US industrial firms. Figure 7.3 shows that the three main channels of RPTs are: real estate asset acquisitions from related parties (57.4 %), income earned from related parties (22.2 %), and management fees paid to related parties (14.8 %). Other recurring RPTs (3.3 %) include expenses related to shared-services, such as accounting and services and various consultancy fees including debt advisory and arrangement fees, while other non-recurring RPTs (2.3 %)

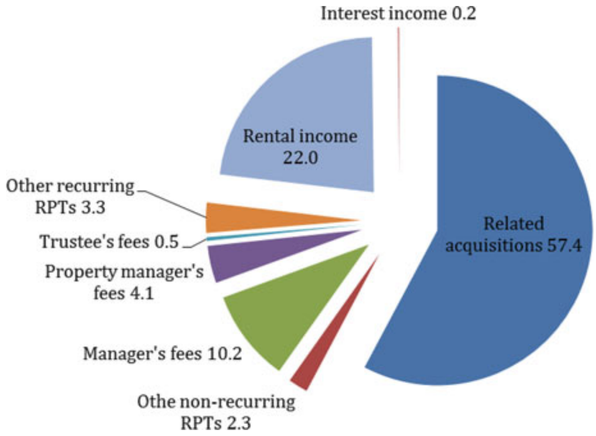

Fig. 7.3 RPTs by Asian REITs (% of total assets) (Source: Ooi et al. 2013)

include interest income, fees related to issuance of securities, banker guarantees and interests paid on loans granted by the sponsor.

With the aim of providing a balanced, contextual view of Asian REITs, APREA designed a corporate governance scoring framework for externally managed REITs in Asia in 2010. Essentially, the scoring framework encompasses 27 governance factors spanning 8 categories of both external and internal corporate governance. Four of the categories are more specific to externally managed REITs, namely REIT Organization, Fees, RPTs and Gearing. The index range is [−11; +88] with a median of 38.5.[5] The framework has been applied by APREA to score corporate governance of S-REITs,[6] and subsequently adapted to other REIT regimes in Asia, such as Malaysia, Hong Kong and Japan. LeComte and Ooi (2013) find a positive correlation between the corporate governance scores and REIT stock price performance. Table 7.3 shows that S-REITs that are ranked above the median score registered 1.6 % points better than those that are ranked below the median score. This implies that corporate governance has a significant impact on REIT stock performance. However, they fail to find any relationship between corporate governance and operating performance of S-REITs. Further analyses carried out by the authors hint that the improved market performance can be attributed to a reduction in information asymmetry enjoyed by better governed S-REITs.

Decomposing the aggregated scores into their components, LeComte and Ooi (2013) find that a positive relationship persists between the respective corporate governance scores and stock returns. Interestingly, the only component that shows

[5] For more details on the scoring framework, see LeComte and Ooi (2013).

[6] Looking at the 8 categories individually, the three best areas are Audit Committee, Board Matters, and Gearing whereas Remuneration, Fees, and RPTs are laggards. Noticeably, Fees is the sub-score with the largest standard deviation, indicating a great diversity of practices related to fees among S-REITs. Remuneration ranks consistently low as many REITs do not provide any information.

Table 7.3 Stock performance of S-REITs (partitioned by corporate governance scores)

Year	No of REITs	Median CG scores	Returns (Portfolio > CG median score)	Returns (Portfolio < GC median score)	Return differences
2004	3	22.50	0.368	0.150	0.217
2005	7	22.50	0.021	−0.102	0.123
2006	12	22.00	0.131	0.027	0.103
2007	17	23.00	−0.151	−0.215	0.179
2008	21	24.25	−0.076	−0.091	0.015
All	64	22.50	−0.043	−0.060	0.016

Source: LeComte and Ooi (2013)

an inverse relationship is RPT score, which implies that REITs actually add value as they engaged in more RPTs. This result is confirmed by Ooi et al. (2013) who examined the incidence of RPTs and their economic impact on Asian REITs. Contrary to the common perception that RPTs are detrimental due to wealth expropriation, the authors observed that RPTs actually have a positive impact on firm valuation and isolate the benefits to flow primarily from the ad hoc acquisitions of properties from the REIT's sponsors.[7] An economic explanation to this phenomenon would be the efficient "supply chain" relationship where an affiliation to a strong conglomerate may be beneficial to a young and financially constrained firm which has high growth potential. This underscores the importance of the sponsor providing pipeline support for the newly listed REIT to grow, which is particularly relevant in the context of young REITs without any track record. Indeed, half of the sponsors of Asian REITs are property developers who develop and own sizeable portfolios of investment properties that may be transferred to the REIT at the appropriate time. In summary, although RPTs raises corporate governance issues, controversial RPT is unlikely given the relatively stringent process imposed by the regulators on RPTs, and the fact that most of the RPTs would also involve equity funding (see J. P. Morgan 2012).

7.5 REIT Managers' Fees

Since an externally managed REIT has no employees, the structure generates an array of fees from the Trust to the Manager, the Property Manager, and the Trustee. In particular, the Manager performs all work on behalf of the Trust in exchange for fees, which include a base fee, a performance fee, and in some cases,

[7] One third of the properties acquired by J-REITs and S-REITs between 2002 and 2007 were procured from related parties. On the "fairness" of the transaction price of assets transferred from the controlling shareholders to the REIT, Ooi et al. (2011) did not find any significant difference in the abnormal returns associated with news of related and arms-length property acquisitions by Asian REITs. Thus, the evidence suggests that sponsors do not sell the properties to the REITs at an inflated or discounted price.

acquisitions/divestment fees. Base fees and performance fees can take many shapes, from a flat percentage of the AUM to a percentage of net income conditional on a pre-determined benchmark, or any combination in-between. Thus, the amount of fees payable to the REIT manager is another contentious issue linked to an externally-managed REIT.

Table 7.4 summarizes the compensation structure of the external managers of 20 S-REITs. The annual base fee of the managers is dependent on the size of the asset portfolio, ranging from 0.10 % to 0.50 % of AUM. In addition, the managers receive an incentive fee which is often charged as a fixed percentage of the portfolio's "income", with the definition varying across REITs. In a few cases, it is defined as cash flow, while in other cases, it is defined as gross income. The most popular definition though is net operating income (NOI) which is adopted by 65 % of the S-REITs. Since it is calculated net of expenses, it is argued that REIT managers are also incentivized to control operating costs. Table 7.4 shows that the incentive fee ranges from a low of 3.0 % to a high of 5.25 % of a REIT's net property income. In addition, the external REIT manager is also entitled to charge an acquisition fee, generally 1 %, and a divestment fee of 0.5 %. In most instances, the sponsor also provides property management services and leasing services, for which separate charge will be charged.

The annual base fee earned by the average REIT manager is approximately US$ 5.0 million (based on an average base fee of 0.375 % and portfolio size of US$1.34 billion). The performance fee contributes another US$ 1.2 million (based on 4.22 % average percentage fee and US$35.5 million average annual net income) to the manager's fees, giving a combined remuneration of US$ 6.2 million annually. As a percentage of AUM, the total compensation of S-REIT managers is approximately 0.54 %. Given the low rental yields of prime real estate in Singapore, the fees translate to around 17.5 % of net revenue earned, which is not an inconsequential amount.

Table 7.4 also shows that 5 of the 20 S-REITs linked the payment of incentive fee to a predetermined benchmark, which could either be based on the trust's performance in the preceding year, or the sector's performance in the current period. They are Ascendas REIT, MacArthurcook REIT, Ascott Residence Trust, Cambridge REIT and Prime REIT. Employing an internal historic benchmark, Ascendas REIT and MacArthurcook REIT managers will only be paid an incentive fee (0.10 % of AUM) if their distribution per unit (DPU) grows by more than 2.5 % year-on-year.[8] Similarly, Ascott Residence Trust's manager will be entitled to an incentive fee only if its gross profit increases by more than 6 % annually.[9] The incentive fee hurdle for the managers of Cambridge REIT and Prime REIT, on the other hand, is linked to an external index which tracks the performance of other

[8] The incentive fee increases to 0.2 % of AUM if the DPU growth exceeds 5 %.

[9] The incentive fee is equivalent to 1 % of the difference between the financial year's gross profit and 106 % of the preceding year's gross profit.

Table 7.4 Fee structure of Singapore REITs

NO	REITs	Date of listing	Base fee (% of asset value)	Performance fee	Acquisition (%)	Disposition (%)	Benchmark for incentive fee
1	Capital Mall Trust	Jul-02	0.25	2.85 % of gross revenue	1.00	0.50	No
2	AREIT	Nov-02	0.50	0.1 %, 0.2 % of asset value	1.00	0.50	Yes
3	Fortune REIT	Aug-03	0.30	3 % of net property income	1.00	0.50	No
4	Capital Commercial Trust	May-04	0.10	5.25 % of net property income			No
5	Suntec REIT	Dec-04	0.30	4.5 % of net property income	1.00	0.50	No
6	Prime REIT	Sep-05	0.50	5 %, 15 % of excess returns	1.00	0.50	Yes
7	Mapletree Logistic Trust	Jul-05	0.50	3.6 % of net property income	1.00	0.50	No
8	Ascott Residence Trust	Mar-06	0.30	4 % of gross revenue + 1 % of excess returns	1.00	0.50	Yes
9	Allco Commercial Trust	Mar-06	0.50	3.5 % of net property income	1.00	0.50	No
10	K-REIT Asia	Apr-06	0.50	3 % of net property income	1.00	0.50	No
11	Fraser Centrepoint Trust	Jul-06	0.30	5 % of net property income	1.00	0.50	No
12	CDL Hospitality Trust	Jul-06	0.25	5 % of net property income	1.00	0.50	No
13	Cambridge Industrial Trust	Jul-06	0.50	5 %, 15 % of excess returns	1.00	0.50	Yes
14	CapitaRetail China Trust	Dec-06	0.25	4 % of net property income	1.50	0.50	No
15	First REIT	Dec-06	0.40	5 % of net property income	1.00	0.50	No
16	MacArthurcook Ind. REIT	Apr-07	0.50	0.1 %, 0.2 % of asset value	1.00	0.50	Yes
17	Ascendas India Trust	Aug-07	0.50	4 % of net property income	1.00	0.50	No
18	Parkway Life REIT	Aug-07	0.30	4.5 % of net property income	1.00	0.50	No
19	Saizen REIT	Nov-07	0.50	Nil	1.00	0.30	No
20	Lippo Mapletree Indo REIT	Nov-07	0.25	4 % of net property income	1.00	0.50	No

Source: Ooi (2009)

This exhibit tabulates the compensation structure of 20 REITs listed on the Singapore Exchange as at April 2008. Acquisition (disposition) fees are stated as a percentage of the purchase (sale) price of the property

REITs. In addition, their incentive fee is charged in two tiers depending on the extent of outperformance.[10]

In his study on remuneration structure of S-REIT managers, Ooi (2009) evaluated the effectiveness of the base fee, incentive fees, and performance benchmarks in promoting superior performance. The evidence shows that firstly, REIT performance is inversely related to the size of the base fee, implying that REITs that pay a bigger base fee tend to register lower performance. Secondly, the size of the incentive fees has a positive impact on REIT performance. This is consistent with the notion that incentive fees align the interests of the managers with that of the shareholders. Thirdly, REITs that adopt performance benchmarking performed better than those without performance benchmarking. Fourthly, the market also rewards sponsors that structure their managers' remuneration on a low base fee and a high performance fee which has a hurdle benchmark.

In summary, remuneration structure of REIT managers has a positive influence on stock pricing during the IPO as well as on their performance over the long run. The results have a practical implication on REIT sponsors in Asia, who typically retain control of the asset management company. While they may structure a REIT to pay high management fees, the market is not blind to this possibility. In particular, the market appears to penalise such structures with a higher price discount during the IPO. Thus, the potential benefits of earning higher recurrent management fees have their boundary. On balance, the empirical results indicate that it may be better for the sponsors to structure the manager's fee to be based more on performance, rather than on asset size. Not only do the sponsors get a better valuation at IPO, the REIT shareholders also enjoy higher returns since the managers are motivated to work harder for their fees.

7.6 Conclusion

Moving forward, the Asian REIT markets will continue with their growth trajectory. A number of property owners operating in existing REIT markets have announced plans to launch new REITs. In addition to publicly listed REITs, the first open-ended private J-REIT was launched by Nomura Real Estate Development in 2010, followed by other asset management companies set up by Mitsubishi Estate, Mitsui Fudosan and Goldman Sachs (CBRE 2012). These developments

[10] The performance fee is calculated in two tiers: Tier 1 performance fee equal to 5 % of the amount by which the total return of the trust index exceeds the total return on the benchmark index, multiplied by their equity market capitalization. Tier 2 performance fee is applicable only when the total return of the trust index is in excess of 2 % per annum (1 % for each half year) above the total return of the benchmark index. This tier of the fee is calculated at 15 % of the amount by which the total return of the trust index is in excess of 2 % per annum above the total return of the benchmark dex, multiplied by their equity market capitalization.

coupled with ongoing efforts to introduce REITs in untapped markets, such as China and India, promise a bright prospect for Asian REITs.

Currently, almost all the existing REITs in Asia are externally managed. Since their fees are pegged to the AUM, external managers have understandably sought to increase the size of the REIT portfolio. Although empirical studies have shown that such aggressive strategy to grow by acquisitions, both through arms-length transactions and RPTs, has not been detrimental to shareholder's wealth, it cannot be guaranteed that this will remain in the future with REITs starting to broaden their investment scope overseas. By venturing overseas, any benefits from scale economies would have to be weighed against the risk that real estate is essentially a local game. Moreover, it is expected that investors will become more discerning of good corporate governance and management practices. Extrapolating the experiences in the US and Australia, which started as externally managed models but have over time gravitated towards the internally managed structure, a key milestone for the development of the Asian REIT markets would be the internalization of the REIT management. Moving forward, we will see further improvements in the corporate governance practices in Asia to align the interests of the sponsors and investors.

References

CBRE. (2011 & 2012). *Asia REIT – View Point.*

CFA Institute. (2011). *Asia-Pacific REITs – Building trust through better REIT governance.*

Lecomte, P., & Ooi, J. T. L. (2013). Corporate governance and performance of externally managed Singapore REITs. *Journal of Real Estate Finance and Economics, 46*, 299–320.

Morgan, J. P. (2012). *Singapore REITs. Scorecard for the last decade.*

Ong, S. E., Ooi, J. T. L., & Kawaguichi, Y. (2011). Seasoned equity issuance by Japan and Singapore REITs. *Journal of Real Estate Finance and Economics, 43*, 205–220.

Ooi, J. T. L. (2009). The compensation structure of REIT managers: Impact on stock valuation and performance. *Journal of Property Research, 26*, 309–328.

Ooi, T. L. J., Newell, G., & Sing, T. F. (2006). The growth of REIT markets in Asia. *Journal of Real Estate Literature, 14*, 203–222.

Ooi, J. T. L., Ong, S. E., & Neo, P. H. (2011). The wealth effects of property acquisitions: Evidence from REITs. *Real Estate Economics, 39*(3), 487–505.

Ooi, J. T. L., Wong, W. C., & Ong, S. E. (2012). Can bank lines of credit protect REITs against a credit crisis? *Real Estate Economics, 40*, 285–316.

Ooi, J. T. L, Wong, W.C., Ong, S. E., & Downs, D. (2013). *Related party transactions and REIT valuation* (Working paper). National University of Singapore.

RiskMetrics Group. (2009, November). *As safe as houses – Examining the corporate governance of listed real estate investment trusts in Singapore.*

Tang, C. K., Mori, M., Ong, S. E., & Ooi, J. T. L. (2013). *Debt raising and refinancing activities by Japanese REITs: Information content in a credit crunch* (Working paper). National University of Singapore.

Wong, W. C., Ong, S. E., & Ooi, J. T. L. (2013). Sponsor backing in Asian REIT IPOs. *Journal of Real Estate Finance and Economics, 46*, 299–320.