REITs: asset classes and activity comparisons

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One of the highlights of Malta's Budget 2019 was the announcement that the government intended to launch a Real Estate Investment Trust (REIT) regulatory framework. Malta is one of the few developed countries not yet having established such a regime. Therefore, the current initiative to tackle this matter, has been more than welcome by the industry and investors at large.

REITs first came into existence in 1960 when the US Congress determined that through the purchase of equity, a group of smaller investors would also be able to participate in larger-scale real estate opportunities, with the capability of producing larger incomes. Since then, more than 30 countries worldwide have established a REIT regime. Throughout the years, such regimes have developed, resulting in established REITs even considering putting themselves up for sale, to maximise value to shareholders. A recent example of this is Ireland's first real estate investment trust, Green REIT, with property assets of €1.5 billion, deciding to focus on the sale of the company or its portfolio of assets. Green REIT's portfolio is 83 per cent office space in the Dublin area, with tenants including Barclays and Allied Irish Banks.

Put simply, REITs are vehicles that own and operate revenue-producing real estate or related assets. As an investment vehicle for real estate, REITs are mostly comparable to funds, allowing both minor and large investors to gain ownership in income-producing real estate assets.

The main differentiators between a REIT and any unit-linked property fund is that unlike REITs, funds are not required by law to distribute a percentage of their net property related income to shareholders on a yearly basis. Another differentiating factor is liquidity, with REITs tending to be more liquid than direct property holdings, with the latter many times having to impose a 'deferral period' when investors redemption requests cannot be met. REITs are also typically set up in Europe as public companies listed on regulated stock exchanges.

Revenue generation through rental income is the most important element of a REIT. The nature of the REIT vehicle intrinsically seeks to avoid the progression into a property speculator or developer.

REITs may typically invest in both residential and commercial real estate. Some REITs may opt to invest in specific properties through a diversified portfolio across various property types and sectors, including residential property, office buildings, shopping malls, showrooms, hospitals, hotels, storage facilities, and much more.

Other REITS opt to merely invest in one asset typology. Through their specialised teams, REITs typically use sector expertise to maintain a strong property portfolio and provide robust returns to investors. One of the main advantages of investing in a REIT is access to investment quality properties including commercial property that would otherwise be out of reach to smaller investors.

A number of specialised REITs have also served to promote investments having social benefits and supporting local communities, including REITs owning healthcare-related real estate, such as medical centres, doctors' specialised or general practices, hospitals and elderly care homes. Other REITs have also offered inventive options for social housing financing in different countries.

Upon assessing the typology of properties earmarked by REITs in different jurisdictions, one can find a very interesting spread with common factors bringing all these territories together. A short analysis of three main REITs jurisdictions is provided below.

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COMPARATIVE OUTLOOK

US

Under US law, three types of real estate investment trusts exist: equity REITs, mortgage REITs and hybrid REITs.

Such REITs may be formed as a corporate, trust or association. Annually, at least 95 per cent of the REITs gross taxable income must derive from real estate-related income, other interest and dividend income and gains on securities. Quarterly, at least 75 per cent of the value of the REITs gross assets must consist of real estate assets, cash and cash items and US government securities. All REITs are subject to a penalty tax of 100 per cent on the gain from the sales or other dispositions of property as 'dealer property'.

The majority of US REITs consist of equity REITs. It is customary for such equity REITs to invest in a specific type of real estate and not be spread across different property typologies.

> *"Details on Malta's proposed regime have not been announced yet"*

UK

Initially introduced in 2007, UK REITs have developed substantially in the last decade. A UK group REIT encompasses a group of companies with the objects of carrying on a property investment business with the scope of letting such property to third party tenants.

The UK now enjoys a number of larger listed UK property companies that have converted to UK REITs as well as the establishment of a number of start-up REITs. Typically, UK REITs are inclined to focus on definite property asset classes, such as industrial property, commercial property and residential property, excluding the letting of owner-occupied construction.

It is possible for a REIT established in the UK to comprise real estate rental business and other activities.

Ireland

First introduced in 2013, Irish REITs tend to manage assets in their local market even though it is possible for such REITs to hold non-Irish assets. Irish REITs allow investors to invest in a property portfolio as if they owned the property directly (achieving tax neutrality for investors) as well as allowing them to hold a portion of a larger property portfolio thereby achieving diversification and reducing risk. It is possible for an Irish REIT to have both a property rental business and other activities.

Irish REITs must distribute 85 per cent of property-related income and by the end of the first accounting period, at least 75 per cent of the income and the market value of the assets of a REIT must be related to assets of the property rental business. Post the first three-year period, the REIT must conduct a property rental business of at least three properties, with no one property accounting for more than 40 per cent of the total market value of the properties constituting the business. It is interesting to note again that a sort of 'penalty', where a corporation tax is charged when an asset is developed at a cost exceeding 30 per cent of its market value and later transferred within three years of finalisation of such development.

The Malta proposal

Malta's proposed REIT regime and its details have not been announced yet. However, such proposition is expected to bring about several benefits, including easier access to larger real estate investments for minor or average investors (an investment in otherwise inaccessible commercial properties); enhanced investor transparency and specialised and qualified property management. A reality of the Maltese property market lies in the fact that commercial property in Malta is very illiquid. International investors' real estate appetite focuses on major metropolitan centres rather than a small island such as Malta.

Interested local investors are few and far between; Malta does not vaunt local pension funds or family offices normally interested in investing in such commercial property assets and the few local institutional investors that have the resources to invest in commercial real estate, such as local insurance companies and investment funds, may already be near enough or at their highest permissible apportionment. The REITs regime will therefore be very welcome in that it will permit the unlocking of and release of such properties, hence providing alternative funding solutions to such owners.

Being listed on the Malta Stock Exchange as a mandatory requirement will provide investors with more regular and transparent disclosures and one assumes that Malta will have this as a basic requirement. With regards to the asset class, no decisions have been taken yet on whether only commercial real estate assets will be solely permitted or whether both commercial and residential assets will be allowed.

With international REITs regimes having been around for circa six decades, and with benefits ranging from strong return potential, to better property management, to enhanced liquidity, to higher dividend returns and easier reach for more minor investors, the introduction of REITs in Malta is certainly welcome, especially in light of the island's booming property market and local and international investors' appetite to be part of the real estate story. For more information on REITs around the world, visit http://reits.chetcuticauchi.com/reits-comparison