

# Real Estate Investment Trusts (REITs)

By:

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# Government's Priorities

- Generate revenues to finance development initiatives
- Create employment opportunities for a growing and young population
- Provide quality habitat to sustain growing urbanization
- Create a sustainable economic model which is independent of the vicissitude of international finance
- Attract foreign direct investment into the country in order to boost economic activity and foreign exchange reserves

# Contribution of Construction and Housing Industry to the Economy

# Construction / Housing Industry

- Holds the promise to address our pressing economic challenges
- The largest employment provider in the country
- Triggers activity in over 40 sectors of the economy
- Contributes a significant portion to GDP in major economies of the world
  - India 6%
  - UAE 8%
  - Japan 10%
  - UK 10%
  - US 15%

# Challenges to the Construction / Housing Sector in Pakistan

Construction / housing is an ailing sector in Pakistan owing to:

- Obsolete / dysfunctional system of property title and land registry
- Capital starvation / limited financing and high interest rates (lowest mortgage-debt-to-GDP ratio)
- Weak foreclosure and tenancy laws
- Absence of recognized corporate entities limiting quality, innovation and supply

# Capital / Funding Starvation

Country	Mortgage-Debt-to-GDP Ratio
Pakistan	1%
India	5%
China	15%
United Kingdom	42%
United States	70%

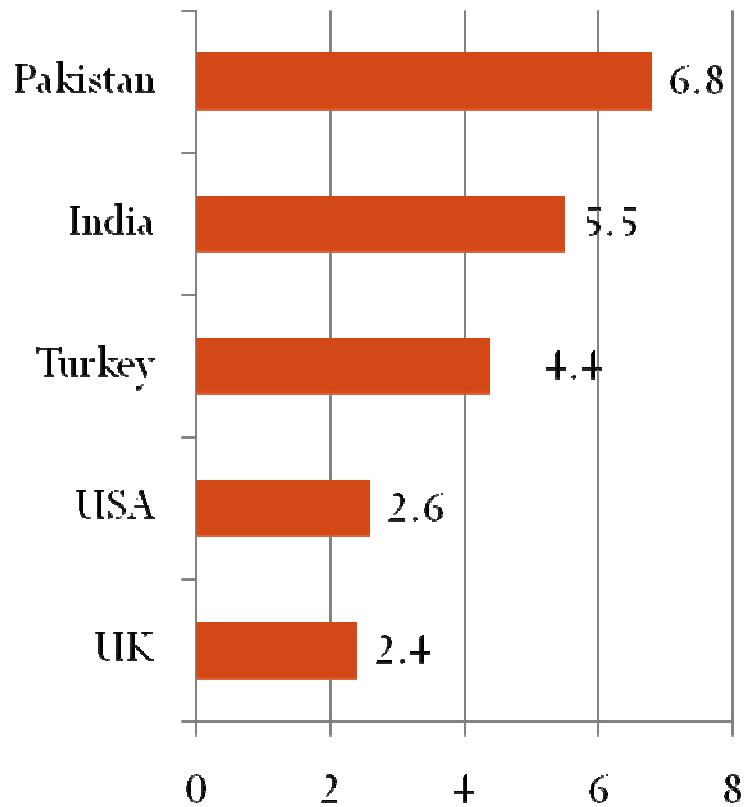
# Capital Starvation Leading to Acute Housing Shortage

Millions of Units	1998 Census	2009 (E)	CAGR
Present Inventory of Houses	19.30	22.68	1.48%
Housing Backlog	5.50	8.65	4.20%
Incremental Annual Requirement	0.57	0.68	1.62%
Annual Production	0.30	0.37	1.92%

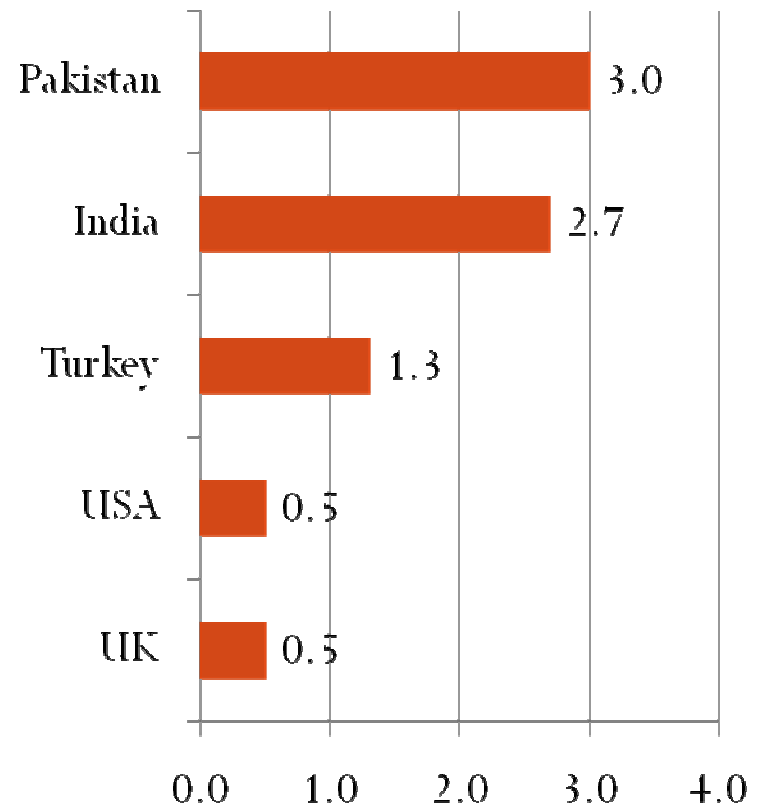
Source: Federal Bureau of Statistics

# Housing Shortage Leading to Suffocated Living

### Average Family Size



### No. of Persons per Room





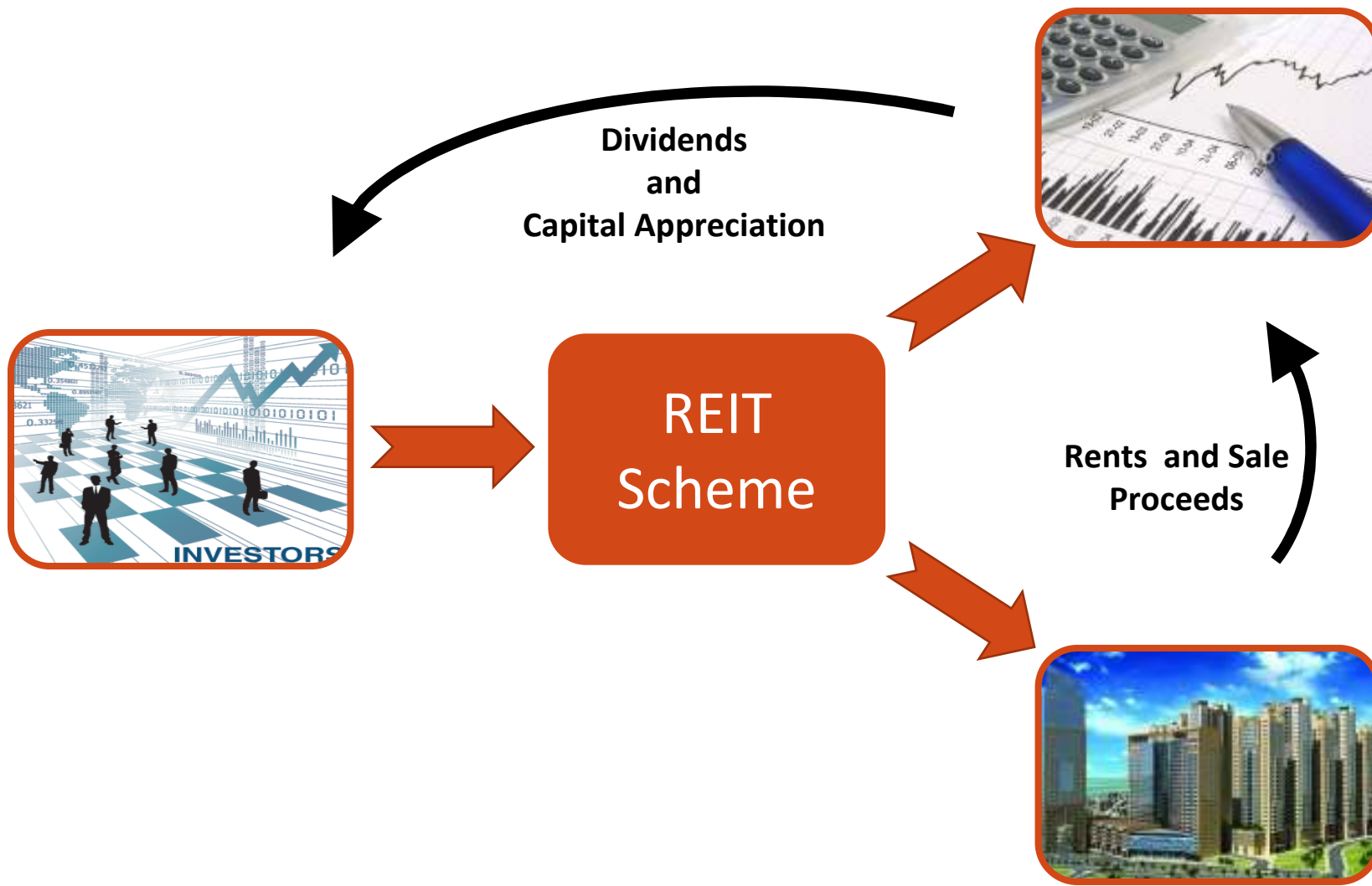
# REIT: An innovative solution to the housing challenge

# What are REITs

- A Real Estate Investment Trust (REIT) is a mutual fund that uses pooled capital of large number of investors to purchase, develop and manage real estate assets
- Units of a REIT fund are listed / traded on a stock exchange

*“REIT is an ideal vehicle for small savers and other individuals to invest in real estate while maintaining the liquidity and benefits of the capital markets”*

# What are REITs



## REITs in Asia

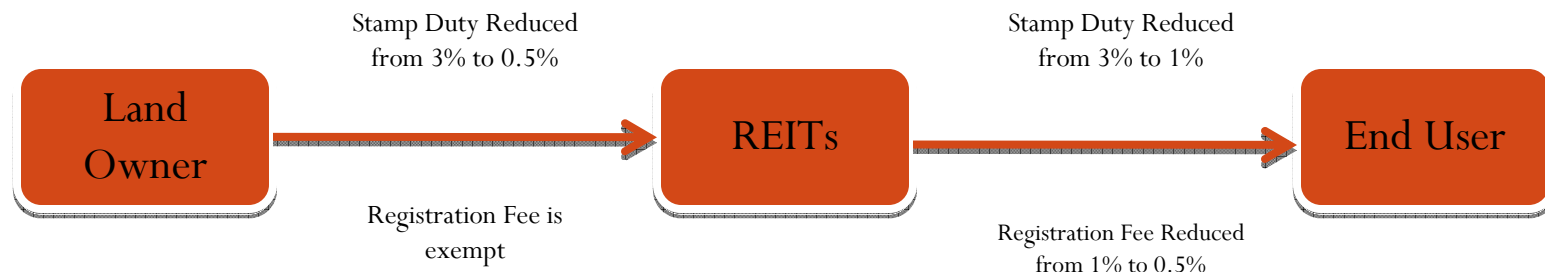
- REITs are currently operative in several Asian economies like Japan, South Korea, Singapore, Malaysia, etc. contributing their share to the economic growth
- REITs in Asia have witnessed growth of over 80% per annum to USD 87 billion during the past 6 years
- According to an estimate, REITs market, in Asia, has the potential to grow to over USD 500 billion

# REITs in Pakistan

- REITs Regulatory Framework was introduced by SECP in January 2008 and subsequent amendments have been incorporated on June 16, 2010.
- These regulations are comprehensive with the principal focus on the protection of interests of general investor in a REIT Scheme
- The Government has provided an important incentive for the success of REITs:
  - Income of a REIT Scheme is granted tax exemption provided it distributes 90 percent of its income to its unit holders

# Arif Habib's Initiative

- To facilitate development of REITs, banks/DFI's investment in units of REIT shall not be counted in the aggregate investment limits of 30% and 45% of equity of banks and DFI's respectively.
- Profits and gains derived from the sale of immovable property to a REIT Scheme is tax exempt up till 2015



# Three Types of REITs

## **Developmental REIT Scheme**

- A Developmental REIT Scheme invests in Real Estate to develop it for Industrial, Commercial or Residential purpose through construction or refurbishment

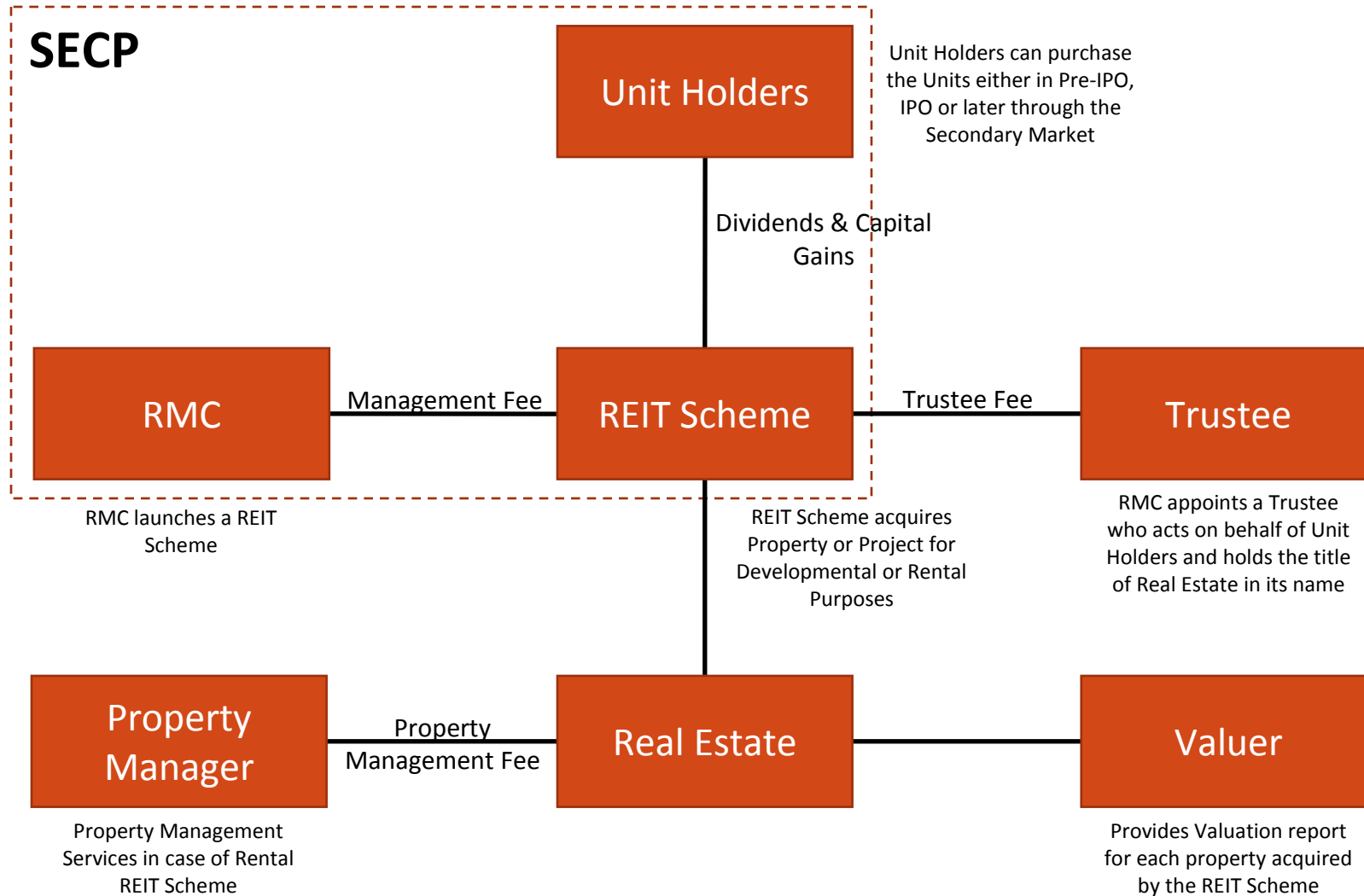
## **Rental REIT Scheme**

- A Rental REIT Scheme invests in commercial or residential Real Estate to generate rental income

## **Hybrid REIT Scheme**

- *REIT Scheme having both a portfolio of buildings for rent and a property for development*

# Key Players of REIT Structure





# Key Features of the Regulatory Framework

## REIT Management Company (RMC)

- Must have adequate systems and resources to provide REIT management services
- Key executives must satisfy 'fit and proper criteria'
- Adherence to strictly defined rules and regulations for proper corporate governance to ensure investors' interest is protected at all times
- Paid up capital requirement now reduced to **Rs. 200 million** from Rs. 500 million

## REIT Scheme

- Listed closed-end unit trust; minimum fund size of **Rs. 2 billion** for Development and Rental REIT Scheme and **Rs. 3 billion** for Hybrid REIT Scheme
- Project means **single or multiple sites** of a Developmental REIT Scheme, and single building and multiple buildings incase of Rental REIT Scheme.

# Key Features of the Regulatory Framework

## REIT Scheme (cont'd)

- Real Estate under management of a REIT Scheme may only be located in federal and provincial capitals
- RMC to hold at least 20% (**max. 60%**) of the REIT Scheme
- Pre-IPO offer up to 55% of the REIT Fund - single pre-IPO investor may hold up to a maximum of 10% of the REIT Fund
- At least 25% units to be offered to public in an IPO - single IPO investor may hold up to a maximum of 5% of the REIT Fund

## Developmental REIT Scheme

- Land value not to **exceed 60%** of the REIT Fund
- Prior to registration RMC to acquire land after full payment
- ***Scheme is allowed to collect up to 90% of the project cost revenue as Customer Advances, however, it is not allowed to use more than 30% of the amount collected***

# Key Features of the Regulatory Framework

## Rental REIT Scheme

- In case of Leasehold land, lease period of at least 30 years
- prior to registration, RMC to enter into binding purchase agreement with ***minimum 10% down payment*** of the total value of the Real Estate which may be in cash or ***units of the REIT Scheme***.

## Borrowing Policy

- ***REIT Scheme has been prohibited from borrowing any funds***

## Valuation

- Valuation of the real estate to be carried out once every quarter by a professional Valuer

# Benefits of REIT to the Economy

# Benefits of REITs to the Economy

REITs can:

- Bring transparency to real estate transactions
- Increase participation of general public in profitable real estate projects and kick start economic activities
- Eliminate housing backlog and provide quality living
- Bring standardization and best practices to the construction industry
- Efficiently channel Foreign Direct Investment and substantially increase government revenues
- Channel capital to non-speculative growth of the real estate sector boosting economic activity
- Boost economic activity leading to creation of millions of direct and indirect job opportunities in various industries linked to real estate sector

# Benefits of REITs to the Economy

- REITs can facilitate government to monetize its land bank in a transparent manner under public-private partnership
- REITs will allow government to raise funding from institutional and retail investors, both local and foreign, to develop its land bank into housing schemes
- Development will ensure steady revenues to the government while creating spiral of economic activity as well as relieving the acute housing backlog
- The spiral of economic activity will lead to creation of millions of direct and indirect job opportunities in various industries linked to real estate sector.

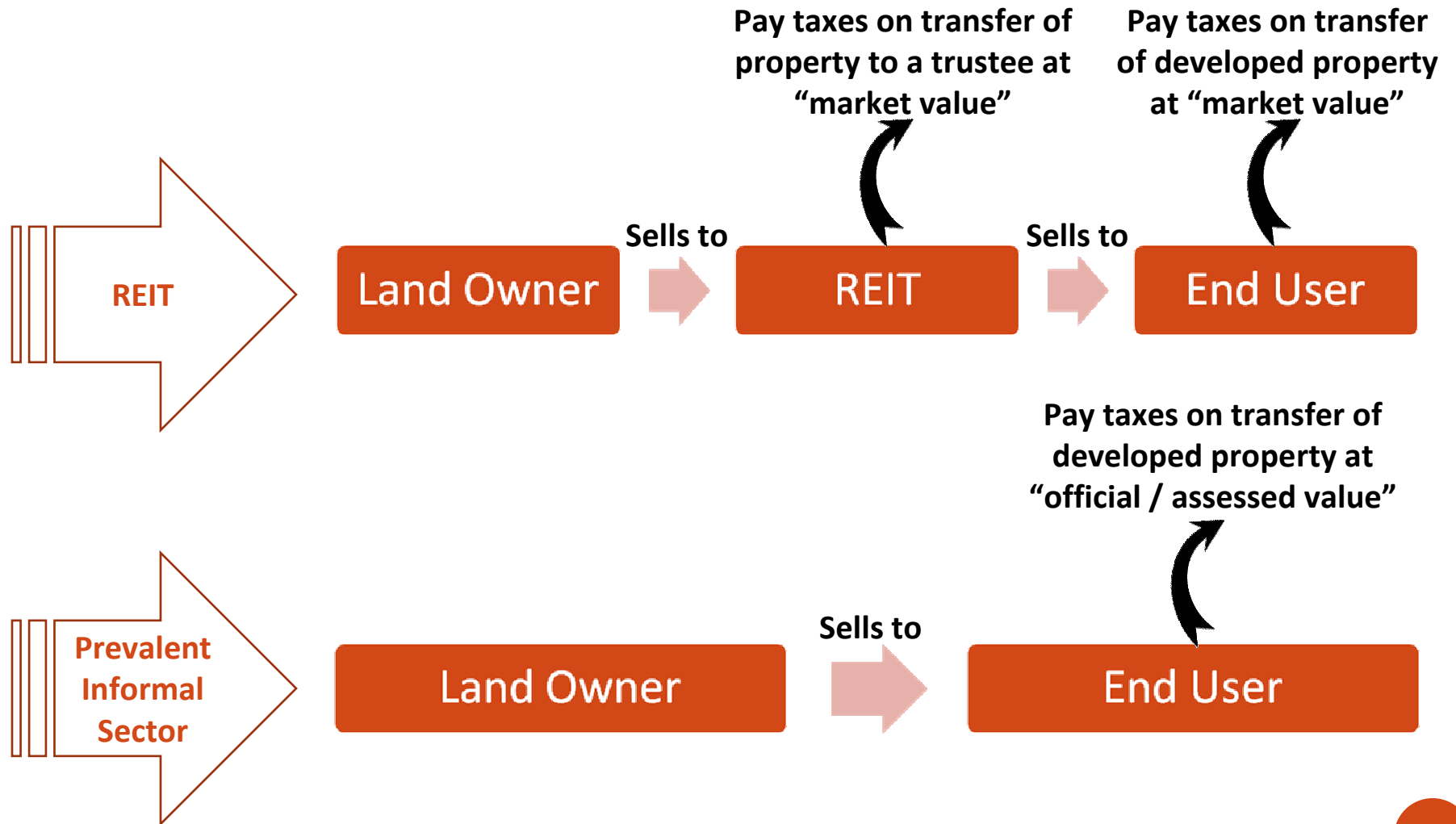
# Impediments to the Success of REITs in Pakistan

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- Presently, REITs are at a distinct disadvantage in comparison to the prevailing informal real estate sector
- Real Estate transactions are subject to:
  - Capital Value Tax
  - Stamp Duty
  - Land Registration Fees
  - Local Government / Town Taxes
- Informal sector pays these taxes at “Official / Assessed” value, whereas, REITs are subject to pay these taxes at “Actual Market” value
- Official / Assessed value is only a fraction of Actual Market value of the real estate subjecting REITs to huge comparative disadvantage



# Tax Burden on REITs



# Support Needed from the Government

# Incentives Required for the Success of REITs

- REITs are exempt from property transfer taxes in Malaysia and Singapore. Other countries also offer similar incentives
- We propose that:
  - CVT, stamp duty, land registration fees and town / local government taxes be waived on transfer of property to REITs
  - These taxes should be levied at “Official / Assessed” value of the property when it is sold by REITs to end users
- REITs be allowed to invest in real estates located in major cities like Faisalabad, Multan, Gujranwala, Sialkot in addition to federal and provincial capitals as presently allowed

Thank you