Guest editorial

The six success factors for REIT market development: lessons for China?

The recently published *Routledge REITs Research Handbook*, which I had the pleasure of editing (Parker, 2018), included six chapters on REITs in different regions of the world, each written by an expert author with an intimate knowledge of the region. Rather than the usual, trite comparative analysis of market capitalisation, distribution requirements, minimum holding levels, tax concessions and so forth, the authors surveyed the development of REITs in their region with a focus on the structural and market features that differed between regions.

Ascending by helicopter above the text of each of the six chapters permits a holistic view that allows some common themes and features of six decades of international REIT evolution to be identified and classified as the six success factors for REIT market development:

(1) start diversified;

(2) avoid property company domination;

(3) focus on growth catalysts;

(4) follow the trend for leverage;

(5) optimise government support; and

(6) do not bother without tax breaks.

With China being potentially the world's largest emerging REIT market, could the six success factors offer lessons for China?

Success factor 1: start diversified

The common approach around the world appears to be for an REIT industry to start with diversified REITs and then see the emergence of sector-specific REITs later, with this global trend starting in North America (Case, 2018).

The USA started with diversified REITs then broadened into industrial, retail and office REITs before broadening further into infrastructure, data centre and timberland REITs. Similarly, Canada started with diversified REITs and retail REITs before broadening into residential and office REITs and then broadening further into health care, industrial and hotel REITs. Following the pattern, Mexico started with diversified and industrial REITs before broadening into hotel and retail REITs.

For those regions where a significant property company and unlisted fund market already exists, an evolving REIT market may forgo the initial diversified portfolio phase and move straight into sector-specific REITs, as happened in the UK (Moss, 2018).

Success factor 2: avoid property company domination

There is an apparent commonality around the world that, where a jurisdiction has a well-established property company or fideicomiso market, an REIT market may have difficulty gaining traction and becoming established.

Hong Kong had a long-standing and well-understood property company market which, with the absence of tax transparency, provided structural challenges for the development of a REIT market (Ooi and Wong, 2018).

Journal of Property Investment & Finance
Vol. 37 No. 3, 2019
pp. 238-240

1463-578X
DOI 10.1108/JPIF-04-2019-100

Similarly, across Latin America, recent legislative and regulatory changes in various countries have facilitated a clearer regulatory definition of investment funds as a form of indirect vehicle based on the popular, long standing and well recognised legal entity, the fideicomiso, which emerging REITs are finding hard to displace. Indeed, in Uruguay, REITs do not yet exist with the Real Estate Finance Fideicomiso effectively fulfilling the role (Taltavull de la Paz *et al.*, 2018).

Interestingly, again, the UK has evolved in a contrarian manner where the existing significant property company and unlisted fund market did not preclude the development of an REIT market, though transitional provisions assisted (Moss, 2018). Similar transitional provisions to encourage the transformation of property companies into REITs also operated successfully in Singapore and facilitated the success of the emerging REIT sector (Liow and Yuting, 2018).

Success factor 3: focus on growth catalysts

A series of common catalysts of REIT market growth may be identified around the world. A regular contributor to REIT market growth is a collapse in the direct property market which generates a supply of suitable stock as occurred in Canada (Case, 2018) and the USA in the early 1900s (Case, 2018). Availability of capital may also be a catalyst such as in Poland (Moss, 2018) and the USA after the dotcom crash of the early 2000s (Case, 2018).

Alternatively, the catalyst may be good luck and fortunate timing as occurred in the Spanish REIT market where institutions were structurally underweight equities due to the GFC and a debt-fuelled commercial property collapse preceded the introduction of REIT legislation (Moss, 2018).

Success factor 4: follow the trend for leverage

Leverage in REITs changed dramatically following the GFC with existing REITs around the world delivering and the acceptable level of debt plummeting. Since the GFC, various countries have introduced leverage constraints into their REIT markets including Spain (Moss, 2018) and Thailand limiting leverage to 60 percent for an REIT with an investment grade rating (Liow and Yuting, 2018).

Some countries have gone further, with South Africa introducing 60 percent leverage, a requirement for a risk monitoring committee and a prohibition of the use of derivatives except in the normal course of business and India introducing a limit of 49 percent of the value of assets, with a requirement to provide a credit rating and obtain unit holder approval if gearing is to exceed 25 percent of the value of assets (Lee, 2018).

Success factor 5: optimise government support

While there are examples around the world of government policy driving REIT growth and of REIT growth driving government policy, a common feature that emerges is the significant benefits of optimising whatever policy support government provides.

The Singapore Government is a major supporter of S-REITs with positive regulatory intervention (Liow and Yuting, 2018) while the Japanese Government supported J-REIT growth through the Bank of Japan's buying J-REITs as part of its quantitative easing programme (Ooi and Wong, 2018). Similarly, while the development of an REIT futures market in Australia was industry driven, it was facilitated through supportive government regulation (Lee, 2018).

Success factor 6: do not bother without tax breaks

While it is commonly accepted that tax transparency is one of the fundamental beneficial features of REITs, several countries have introduced REITs without tax benefits and unsurprisingly then seen the sector stagnate.

Hong Kong does not offer tax transparency which provides a structural challenge for the REIT sector (Ooi and Wong, 2018) with fideicomisos in Latin America offering a diverse range of tax benefits which further undermine growth in the REIT sector (Taltavull de la Paz *et al.*, 2018).

Lessons for China?

While the six success factors for REIT market development may not appear surprising to experienced REIT market observers, it is fascinating how the absence of only one may severely curtail REIT market development in a particular country.

The fascinating test case for the world of REIT development will be China, where success factors one to four should be easily achievable. Starting with diversified REITs in a market where existing alternative structures do not dominate, capital is readily available and leverage constraints can be implemented should provide solid foundations for significant growth in the Chinese REIT market.

It is, however, in success factors five and six that the challenge may lay for China. Positive government policy support and a willingness by the various layers of government to provide tax transparency could lead to the development of the world's largest REIT market, whereas the converse could stifle any REIT market growth with the Hong Kong experience not boding well.

David Parker
University of South Australia, Adelaide, Australia

References

Case, B. (2018), "North America", *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Lee, C.L. (2018), "Oceania", *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Liow, K.H. and Yuting, H. (2018), "South East Asia", *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Moss, A. (2018), "Europe", *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Ooi, J.T.L. and Wong, W.C. (2018), "North Asia", *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Parker, D. (Ed.) (2018), *The Routledge REITs Research Handbook*, Routledge, Abingdon.

Taltavull de la Paz, P., da Rocha Lima, J. and Alencar, C.T. (2018), "Latin America", *The Routledge REITs Research Handbook*, Routledge, Abingdon.