Article

REITs in China

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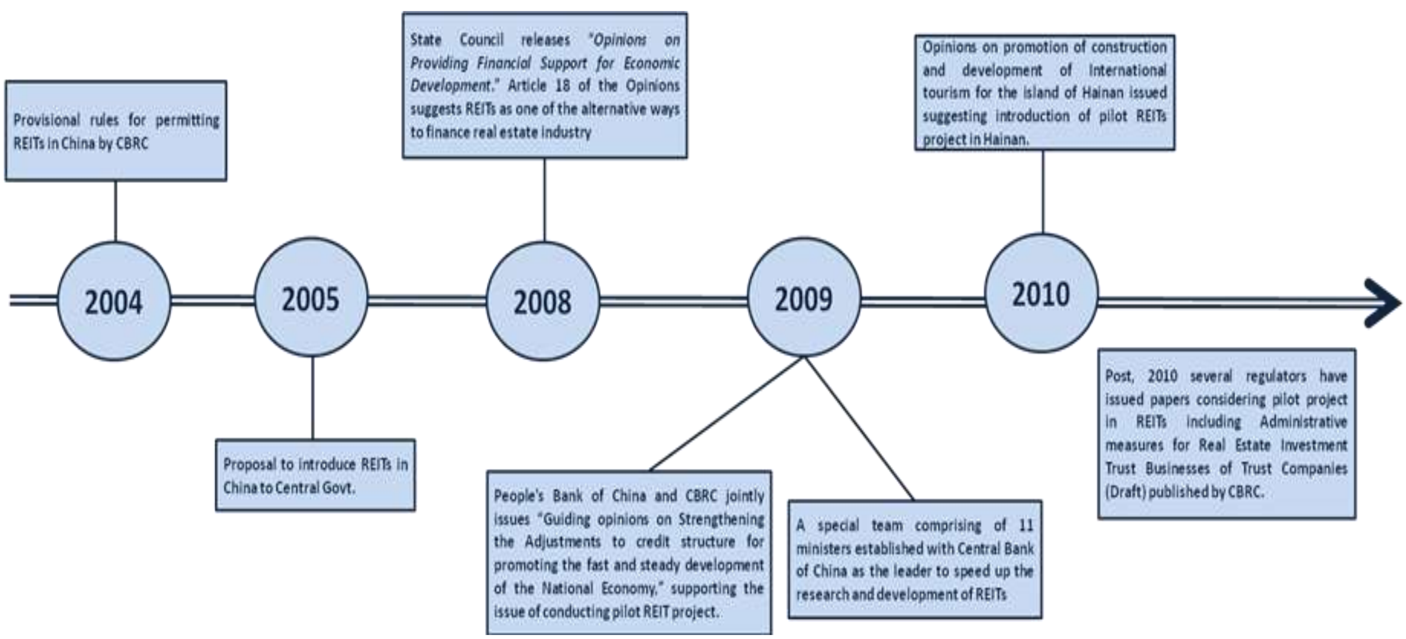
Real Estate Investment Trusts (REITs) as a concept is prevalent in 30 countries world-over and allows investors to access high value illiquid real estate assets. Asia accounts for US$7 trillion in investable real estate, being 25% of the global market. By 2020, this is expected to grow significantly to US$17 trillion and be 35% of the global market; largely driven by the strong growth in the Asian emerging real estate markets. Asia now also accounts for 18% of global commercial real estate transaction activity, being over US$335 billion in the last five years[1]. Asia being the epicentre of activities several Asian economies are keenly looking at introducing REITs regime in their countries. If we were to focus on Asia only, currently, there are 138 Asian REITs with a total market capitalisation of more than $118 billion, accounting for 12% of the global REIT market.

China too began its trial run for REITs in 2004. The Chinese real estate developers have been heavily dependent on bank finance for construction and development of projects hence need for alternative and diversified investment instrument has been felt. Over the years several regulatory initiatives have been undertaken to make REITs a reality in China. The timeline below illustrates the efforts of the Chinese regulators over the years to introduce REITs into the country.



Source: Author's compilation

REIT has been considered as an alternative form of financing for the real estate industry in China however the financial product was put on a back burner during the global financial crisis of 2008. With the reviving interest in asset securitization in China since 2012, there is a renewed interest in REITs as well.

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[1] http://www.propertyoz.com.au/library/APREA_The-Investment-Characteristics-and-Benefits-of-Asian-REITs-for-Retail-Investors-report.pdf

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Currently there is no regulatory regime existing for REITs in China and for REITs regime to take effect in China there are several legal, regulatory and tax hurdles. The real estate registration system is not comprehensive in China; there is legal and tax ambiguity on the property transfers. A developer transferring a property to a REIT will be subject to several taxes including enterprise income tax, land appreciation tax, business tax and stamp duty and the REIT would be subject to deed tax making the property tax regime burdensome.

Typically, REITs are highly regulated and highly tax transparent investment in real estate sector. While REITs in essence should be tax neutral for investors, there prevails ambiguity on the taxation provisions of the trust holding real estate in China. In China, in case a company holds real estate, there will be tax on the income earned by the company and there will be a tax on the investors on the distribution of such income resulting in double taxation. The regulators will have to clarify the tax provisions with regard to C-REIT to incentivise real estate companies to consider the instrument. Further, regulators will have to clarify whether C-REITs will be able to invest in properties outside the Chinese mainland or restricted to domestic property; also whether foreign investors will be able to invest in REITs or not will determine the development of the REIT regime in China. Currently the regulators are holding the view that C-REITs should be traded on inter-bank market rather than publicly traded this will result in institutional investors investing in the instrument rather than retail investors.

In 2013, Switzerland based UBS has made an offering of investment in private equity fund in China which can be termed as a pre-REIT fund. The fund will be investing in subsidized housing market which could be later converted into a REIT once the regulatory regime offers clarity on the structure. Currently, the real estate fund is largely unregulated.

Among the emerging economies, neither China nor India have their own REIT market, however Singapore and Hong Kong REITs are enabling retail investors to effectively access China and India real estate portfolios via Singapore and Hong Kong REIT markets and have performed well. While foreign REITs having exposure in the properties in China have performed well, Chinese investors are yet not permitted to make investments in their own market's prosperity.

REIT regime requires certain amount of preparation before introduction into the system, Chinese regulatory environment poses several regulatory challenges and hence REITs may take longer to come into effect in China.

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