FOCUS ON REITS

REITs Continue Global March

The U.K. Joins Other Countries in Considering REITs

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THE U.K.'S RECENT ANNOUNCEMENT OF THE LIKELY ADOPTION of the U.S. REIT model underscores an important global trend that could spell opportunity for U.S. REITs and other U.S. real estate players by facilitating both foreign investment and foreign capital raising.

Earlier this year, in his annual budget statement to Parliament, U.K. Chancellor of the Exchequer Gordon Brown, accepted the recommendations of the so called "Barker Review" that calls for the introduction of REITs in the U.K. The Barker Review concluded that "there is merit in the Government considering a vehicle, based on the U.S. Real Estate Investment Trust model, to encourage increased institutional investment" and suggested that the introduction of a REIT-like regime could revitalize the U.K.'s stagnant property sector and "improve liquidity, transparency and scrutiny, [and] provide access to property for long-term savings ...." Concurrently with the acceptance of the Barker Review's interim recommendations, the U.K. Treasury and the Inland Revenue issued a consultation paper entitled "Promoting More Flexible Investment in Property" available at:
http://www.hm-treasury.gov.uk/budget/budget_04/associated_documents/bud_bud04_adproperty.cfm

The consultation paper considers a wide-ranging reform of the tax treatment of property investment and explores various proposals for the structure of the U.K. version of REITs that are likely to be known as *Property Investment Funds* ("PIFs"). Although it does not include specific recommendations for the structure of PIFs, the consultation paper considers structures from other national experiments with REITs including Australia, Belgium, Canada, France, Hong Kong, Japan and Singapore, in addition to U.S. rules. The consultation paper does suggest, however, that the U.K. government would likely support a high earnings redistribution level (perhaps 90%) and that PIFs would be required to be listed on an exchange. In addition, there will likely be an as yet unspecified conversion charge from an existing form of property ownership to a PIF that will offset the immediate tax loss to the Inland Revenue as a result of conversions. Final details of the structure of PIFs will be considered as part of a public consultation period.

The U.K. REIT experiment is part of a growing trend among countries to adopt REIT and REIT-like structures. In recent years, REIT-like rules have emerged in over twenty countries on six continents from South Korea to South Africa—each with its own unique set of regulations. In the last three years alone, France, South Korea, Japan, Singapore, Taiwan and Hong Kong have adopted legislation creating REIT-like regimes. Although Hong Kong REITs are subject to a geographical limitation on investment to Hong Kong properties only, lobbying efforts are underway to remove that restriction to permit investment in mainland China. In addition, the European Union is said to be in the early stages of considering a "EuroREIT" structure that would be applicable anywhere in the Eurozone.

While these new REIT regimes are likely to experience their own local variety of growing pains, it remains unclear exactly what impact they will have on U.S. REITs.

Although direct foreign investment by U.S. REITs has been relatively insignificant to date, there is a growing trend towards offshore investment through joint ventures with local owners and investors. The following are just several examples of U.S. REIT foreign investment: (1) Macquerie Bank Ltd. (ASX: MBL) has entered into separate joint ventures with ProLogis, Inc. (NYSE: PLD) (which itself established funds in North America, Europe and Japan), CBL & Associates Properties, Inc. (NYSE: CBL) (which itself has foreign investment through various funds in Europe and Asia), and Developers Diversified Realty (NYSE: DDR) to establish three listed Australian property trusts, (2) Simon Property Group (NYSE: SPG) (which already holds interests in assets in Europe and Canada) and Italy's Rinascente Group have entered into a joint venture to develop shopping malls in Italy, (3) Shurgard Properties, Inc. (NYSE: SHU) holds a minority interest in an entity that owns storage centers in six countries, (4) Chelsea Property Group (NYSE: CPG, which recently announced that it has entered into an agreement to be acquired by Simon Property Group) has entered into joint ventures with Mexican and Japanese partners to develop outlet centers in major metropolitan markets in those countries, (5) AMB Property Corporation (NYSE: AMB) has acquired a global network of air cargo and logistics facilities in Paris, Frankfurt, Madrid and Tokyo and is developing various facilities in Mexico with a local partner, and (6) Kimco Realty Corporation (NYSE: KIM) has entered into a joint venture with RioCan Real Estate Investment Trust, a Canadian REIT (TSE: REI.UN) to purchase shopping centers in Canada.

As U.S. REITs consider making foreign investments for the first time, joint ventures may be the investment vehicles of choice to test foreign markets. If they are structured properly, joint ventures can provide access to partners with local expertise and capital while also limiting a REIT's foreign investment risk in an uncertain new market. Seasoned U.S. REITs may be in a unique position to manage the risks of foreign investment by using lessons learned at home and, as a result, may be able to take advantage of emerging REIT regimes as an opportunity to become global players. ■

About our Featured Columnists

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