

Operation mode, characteristics of REITs of Capitaland, Singapore and its enlightenment to China

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ABSTRACT : *This paper studies the operation mode of Real Estate Investment Trusts (REITs) of Capitaland, Singapore and summarizes its development characteristics, as well as analyzes its enlightenment to the development of China's real estate industry. Combined with China's national conditions and the current situation of the real estate industry, this paper discusses several problems that China's real estate industry should pay attention to when learning from Capitaland's REITs operation mode.*

KEYWORDS -Real Estate Investment Trusts (REITs), Private equity fund, Dual-fund operation mode, Real estate industry

I. Introduction

Because of the favorable relevant policies on real estate asset securitization products in China, a total of 47 real estate asset securitization products have been issued since 2018, with a total amount of 84.7 billion yuan, a year-on-year increase of 54%. How to grasp the opportunity, diversify the capital allocation, at the same time use REITs to realize light asset operation and improve the exit mechanism, reduce the investment risk, has also become a problem worthy of study in the development and operation of China's commercial real estate. Singapore is the second Asian country to launch REITs after Japan, and also the second largest REITs market in Asia. The research on the operation mode of REITs in Singapore is of great significance to the development of China's real estate industry.

II. Research background, significance and literature review

2.1 Research background, significance

China's economy and society have developed rapidly and steadily since the reform and opening up, and the real estate industry has also maintained a rapid growth trend. The real estate investment has increased from 188.1 billion yuan in 1994 to 12 trillion yuan in 2018, becoming an important economic contribution point. Although China's commercial real estate started late, it has gradually become a hot spot of investment in recent years due to the strict control policies on housing. According to the national statistical data, the investment in commercial business housing of real estate enterprise developers nationwide in 2009 was 418.066 billion yuan, accounting for 11.53% of the total investment in real estate development. And it had increased to 1417.709 billion yuan in 2018, accounting for 11.79%, with an average annual growth rate of 23.91%.

With the prosperity and development of commercial real estate, problems in real estate development and management gradually follow, especially the imperfect market exit mechanism, difficult financing and single financing channel. Moreover, because of the large investment amount, long investment return cycle and high operational risk, commercial real estate projects are facing the dual pressure of large capital demand and difficult financing, which makes it particularly important to have the strong support of financial market. With the expanding scale of China's real estate asset securitization market, under the background of the reform and transformation of the domestic financial system and the mode of economic growth, a new type of high-yield and high-liquidity investment product—Real Estate Investment Trusts (REITs) has filled the gap of this kind of financial products in the domestic market, gradually becomes a new direction of commercial real estate financing, and opens up a new financing way for real estate developers. Because of the favorable relevant policies on real estate asset securitization products and the tightening financing channels, a total of 47 real estate asset securitization products have been issued since 2018, with a total amount of 84.7 billion yuan, a year-on-year increase of 54%. How to grasp the opportunity, meet the challenge, diversify the capital allocation, improve the rate of return on investment, at the same time use REITs to realize light asset operation and improve the exit mechanism, reduce the investment risk, has also become a problem worthy of study in the development and operation of China's commercial real estate.

REITs is a kind of securitization of real estate investment, relying on the increment value of real estate projects and rental income. Different from ordinary real estate stocks, REITs distribute the project profits within the scope of law to investors, exempt from corporate income tax. REITs make the operation of the whole real estate market more standardized and institutionalized, provide more choices for the financing channels and exit mechanism of real estate developers, and also become a convenient way for the majority of small and medium

investors to invest in real estate projects.

Singapore is the second Asian country to launch REITs after Japan, and also the second largest REITs market in Asia. Unlike other developed economies, Singapore's REITs market is the most international, and it is the fund-raising center of REITs in Asia^[1]. The research on the operation mode of REITs in Singapore is of great significance to the development of China's real estate industry. It is conducive for China's real estate enterprises to actively face the present situations, learn from each other's strong points and radiate new vitality. It is also conducive for us to deepen understanding of REITs listing rules and market supervision system, and enlightening to promote the further development of China's real estate investment trust fund.

2.2 Literature review on the development of REITs in China

The development of REITs in China is relatively late, and most of them are in the form of similar REITs. Therefore, the research on REITs by domestic scholars is still in its infancy^[2]. In the research of Ren Yu and Xia Jun (2015), the domestic research on REITs started late, and most of them are still limited to the study on its origin, concept, importance and fund model^[3]. Li Zichang (2009) compared and analyzed the main modes of foreign REITs, and proposed the selection mode of public offering and private offering of REITs in China^[4]. Chen Qiong and Yang Shenggang (2009) summarized the experience of the development of foreign REITs, emphasized that tax preference is the basic guarantee and driving force for the development of China's REITs, and pointed out that in the case of imperfect relevant laws and regulations, it is impossible to establish a corporate REITs structure in the short term. In order to protect the interests of investors, contractual REITs can be carried out in the form of trust plan. In addition, they pointed out that China should gradually improve the laws and regulations related to REITs, pay attention to the follow-up of tax, property registration and other supporting rules, and also pay attention to the protection of investors to prevent financial risks^[5]. Wan Rong (2010) suggested that the fund source of REITs should be dominated by social funds, guided by government financial funds, and make proper use of pension funds and insurance funds. At the same time, China should give some preferential tax policies to REITs to promote its development^[6]. Yuan Zhou and He Lunzhi (2016) pointed out that in order to promote the healthy development of China's real estate industry, REITs, a mature real estate investment and financing tool of foreign developed countries, should be used to attract more domestic and foreign real estate investment and broaden the external investment and financing channels of China's real estate. He suggested that China should speed up and enhance the innovation ability of REITs products, strengthen and cultivate a large number of professional REITs institutional investors, and establish and operate the interest protection mechanism for REITs investors in China^[7].

III. Analysis of Capitaland's REITs operation mode

Capitaland is a large diversified listed real estate group in Asia. Headquartered in Singapore, it entered the Chinese market in 1994 and has become one of the largest foreign real estate groups in China. The scale of its real estate investment management business is leading in the world, within 7 listed Real Estate Investment Trusts and Commercial Trusts, as well as more than 20 private equity funds. Its light asset fund mode is considered by the industry as the most suitable mode for the combination of real estate and finance.

In 2000, Capitaland formulated the strategic restructuring plan and related implementation plan, and defined it as the "asset light" strategy. The most critical part of the strategic transformation is the joint layout of dual-funds—real estate private equity funds and real estate investment trusts (PE Funds + REITs). According to different stages of risk and return, Capitaland uses matching financial instruments to undertake investment in different stages of projects: for early projects, they are incubated and cultivated by PE Funds with relatively high risk and high return to improve the return rate. In the form of equity participation in the project, Capitaland can leverage larger projects with less owned capital to solve the financing problem of development and acquisition, being responsible for the development management and enjoys the value-added income of the project. After the projects mature, they are injected into REITs with relatively low risk and stable income, while Capitaland and PE Funds exit to realize stable income and value realization, reduce capital precipitation in commercial projects, improve turnover rate of funds and relieve cash flow pressure. Capitaland enjoys the rental income and management fee income from its subscription to REITs. As a result, the growth path of complete-period real estate investment with real estate fund as the core is formed.

Under the background of Singapore's vigorous development of REITs market, in 2002, Capitaland successfully issued Singapore's first public REIT—Capitaland business trust. Within five years after the issuance, Capitaland made a large-scale property acquisition with the funds raised. From 2004 to 2010, Capitaland successfully issued four public REITs, laying the foundation for its asset light strategic transformation.

PE funds and REITs go hand in hand, making Capitaland form a complete closed-loop chain of investment and exit. In 2006, Capitaland set up CapitaRetail China Development Fund (CRCDF) and CapitaRetail China Incubator Fund (CRCIF), raising about 3.942 billion yuan and 2.79 billion yuan respectively. Meanwhile, CapitaRetail China Trust (CRCT) was also listed in Singapore, and its core asset is retail property in

China. CRCIF is responsible for incubating China projects in the initial stage, while CRCDF is responsible for placing relatively mature projects in CRCT. With the rapid expansion of China's business, in 2007, Capitaland set up CapitaRetail China Development Fund II (CRCDFII), raising about 3.942 billion yuan. Capitaland has also developed this new business model in Malaysia. In 2007, it set up Retail Malaysia Development Fund (RMDF) to raise about 1.774 billion yuan. At the same time, Malaysia REITs—Guikai Trust, which takes office buildings as its core assets, was also listed on Singapore Stock Exchange (SGX). Retail Malaysia Development Fund (RMDF) incubates Malaysian office building projects, which will be put into Guikai Trust to realize value realization after mature. Capitaland has summed up the experience from this real estate financial model, and further makes PE Funds and REITs cooperate with each other to accelerate the progress.

IV. Characteristics of Capitaland's REITs operation mode

4.1 Covering the whole industry chain

As the representative of Singapore real estate enterprises, Capitaland has three roles: real estate developer, operator and asset manager. Its business runs through the whole real estate industry chain.

Development and self-owned mixed operation: Compared with the specialty-subdividing U.S. model in which the development and operation of real estate are carried out by independent companies, mixed operation is the characteristic of Singapore real estate. In addition to the functions of traditional developers, real estate developers need to act as the managers of REITs, not only responsible for the acquisition and disposal of self-owned properties, but also responsible for the daily operation of commercial real estate as operators. In 2018, Capitaland's development assets and self-owned assets accounted for 14.8% and 82.0% of the total assets respectively. From the perspective of revenue and profit sources in 2018, development and self-owned business contributed 39% and 61% of the operating revenue respectively, and 21% and 79% of the net profit before interest and tax respectively.

Mixed operation of self-owned business: In the United States, real estate operators only focus on one type of business, such as Simon Property Group holding shopping malls and Global Logistic Properties holding industrial real estate. While Capitaland has diversified self-owned business, including hotels, apartments, office buildings, shopping malls, etc. In terms of asset distribution in 2018, among the assets of self-owned business, apartments and hotels, office buildings and shopping centers accounted for 19%, 32% and 49% respectively; in terms of income and profit sources, among the income generated by self-owned business, apartments and hotels, office buildings and shopping centers accounted for 34%, 19% and 47% respectively, contributing 9%, 29% and 62% of net profit before interest and tax respectively.

Two wheel drive of real estate and finance: Capitaland is not only a real estate enterprise, but also an asset management company. It is the largest real estate fund management company in the Asia Pacific region. As of 2018, Capitaland has 17 real estate private equity funds and 5 REITs. By the end of 2018, REITs and real estate private equity funds accounted for 57% and 43% of the group's total assets respectively. China's real estate private funds and Singapore REITs accounted for the majority of the funds raised, accounting for 48% and 40% respectively.

4.2 Dual-fund operation mode

Capitaland mainly invests in high-risk and high-yield projects with real estate private equity funds, such as commercial properties and development properties in the cultivation period; mainly invests in properties with stable cash flow and mature commercial properties with REITs. Generally speaking, REITs have the preemptive right to the projects cultivated by private funds, so the real estate enterprises in Singapore have formed a dual-fund matching operation mode, which means cultivated by private funds and then packaged and sold to REITs.

Take CRCT (CapitaRetail China Trust) and two paired private funds as examples. In 2006, REITs with China's retail real estate as its main asset—CRCT listed, with the establishment of two private equity funds CRCDF (CapitaRetail China Development Fund) and CRCIF (CapitaRetail China Incubator Fund) at the same time. As reserve funds, CRCDF delivers relatively mature projects to CRCT, and CRCIF mainly cultivates initial projects which are sold to CRCT after the completion of cultivation to complete the exit mechanism.

V. Enlightenment to the development of China's real estate industry

Capitaland's REITs is not only imitated by Singapore enterprises, but also studied by real estate enterprises in China. With the introduction of REITs, Capitaland is more focused on asset management, improving asset service ability, and enhancing liquidity in the asset light mode, seizing many M&A opportunities. As a multinational corporation, Capitaland has successfully expanded the markets in China, Malaysia and other countries by using "PE Funds + REITs" strategy. However, as a Singapore enterprise, Capitaland is facing different policy, economic and cultural environment from China's real estate enterprises. In view of China's national conditions and the particularity of the development of the real estate industry, although the operation mode of Capitaland's REITs can not be completely copied at present, the experience of Capitaland does bring some enlightenment to China's real estate industry.

We need to pay attention to the following points when learning from Capitaland's REITs operation mode:

First, it should be adjusted according to the current economic and cultural level of our country. The success of Capitaland's REITs lies both in the capital operation and management ability of Capitaland, and the coordination of policies with economic and cultural environment. Among them, Singapore's REITs market is mature, and the favorable policy is particularly important. But China's capital market is not perfect at present, and the level of investors is not as good as that of foreign countries. Whether REITs can run smoothly in China has not been decided yet. Therefore, in the process of following suit, we must adjust and walk out a road of REITs with Chinese real estate characteristics.

Second, take public offering REITs of rental housing as a pilot. At present, China's real estate industry has transitioned from the era of increment to the era of stock, and is facing the difficulties of bank credit crunch, the deterioration of financing environment, the decline of total capital investment and so on. Real estate enterprises begin to pay attention to the real estate financial field with relatively low risk. Among them, the housing rental market is an area of intensive national policies, and housing rental REITs will become one of the important development trends in the future. For the assets whose operation level can meet the market requirements, such as public rental housing assets, we can actively carry out the pilot of public REITs to prepare for the development of China's rental housing market in the next stage.

Third, capital operation and business operation should go hand in hand. An important reason for the slowdown of Capitaland's REITs in recent years is the poor business operation. In the case of fierce competition among e-commerce and peers, Capitaland still adopts the traditional mode to operate shopping centers, which leads to the continuous decline of sales of its real business, and the operation with shopping centers as the main product line is facing greater pressure. Therefore, we should pay special attention to the innovation of commercial operation.

Fourth, plan to cultivate and reserve professionals in REITs. In the early stage of asset light strategic transformation, Capitaland set up a special financial department, which became a strong backing for its real estate finance. REITs is a relatively new financial tool for China's real estate industry, which needs to train and reserve talents consciously.

VI. Conclusion

This paper studies the operation mode of Real Estate Investment Trusts (REITs) of Capitaland, Singapore and summarizes its two development characteristics, covering the whole industry chain and dual-fund operation mode. Combined with China's national conditions and the current situation of the real estate industry, this paper discusses several problems that China's real estate industry should pay attention to when learning from Capitaland's REITs operation mode. First, it should be adjusted according to the current economic and cultural level of our country. Second, take public offering REITs of rental housing as a pilot. Third, capital operation and business operation should go hand in hand. Fourth, plan to cultivate and reserve professionals in REITs.

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