

Market Update

Monday, March 27, 2009

REAL ESTATE INVESTMENT TRUSTS: THE FUTURE FOR PROPERTY INVESTMENT

Real Estate Investment Trusts (REITs) recently took centre stage in Nigeria when the N50billion Union Homes Hybrid Real Estate Investment Trust was launched in September 2008. According to the Promoters, the vehicle was created to provide an alternative investment outlet, within a transparent and tradable structure, to investors with a medium to long term appetite for real estate. As a hybrid REIT, the portfolio consists of property investments and mortgages. This edition of the Alitheia market update provides an overview of REITs, and the challenges and potential impact of a developed REIT sector, particularly within the context of the changing macro economic climate.

INVESTING IN REAL ESTATE THE "REIT" WAY

According to Nippon Building Fund Management Ltd of Japan, a real estate investment trust is a form of financial product the objective of which is to accumulate funds from investors, invest such funds in real estate, and then distribute revenues from rents and profits on the sale of such real estate to the investors. United States of America's National Association of Real Estate Investment Trusts (NAREIT) also defines it as a company that owns, and in most cases, operates income-producing real estate.

A REIT is essentially a portfolio of income producing real estate assets which distributes the majority of its profits as dividend. REITs take several forms, depending on nature of the investment portfolio. REITs are prohibited by law from managing their own assets and day-to-day activities are entrusted to outside specialists. This is understandably so as a REIT is an investment entity not a real estate management outfit.

Equity	Mortgage	Hybrid
<ul style="list-style-type: none"> Funds are applied to acquisition or development of properties. Income is from rent from those properties. 	<ul style="list-style-type: none"> Fund are loaned to developers as mortgage loans Income is from interest earned on mortgages and mortgage backed securities. 	<ul style="list-style-type: none"> A combination of investment dynamics of both Equity and Mortgage REITs Income is from both transaction streams

Figure1: Types of REITs

Prior to the introduction of REITs, investors in quoted property companies suffered double taxation – taxes were paid on the company's profits (corporate tax), and again when the investor received a dividend (withholding tax). This put listed property companies at a disadvantage relative to informal transactions and direct investing (e.g. buying a buy-to-let property). REITs, as "pass through entities" ensure investors do not suffer double taxation as the vehicle is not subject to corporate tax for as long as it meets the stipulated requirements. REITs are a means of pooling investments from multi-level investors into large scale real estate transactions.

REITs IN OTHER ECONOMIES

United States: In response to the need to create an avenue for people other than the wealthy individual and corporations to invest in pools of significant real estate assets such as shopping malls, parks and health care facilities, the US Congress passed the REIT Act in 1960. By 1974, there were only 53 publicly traded REITs in existence, with a combined equity market capitalization of just \$712 million. Further changes to the Act led to a major growth in the sector and by 2007, there were nearly

200 publicly traded companies with a collective equity market capitalization stands at more than \$300 billion (NAREIT). 15 to 20 percent of investment-grade commercial real estate in the U.S are held in REITs.

US REITs Investment In All Property Types

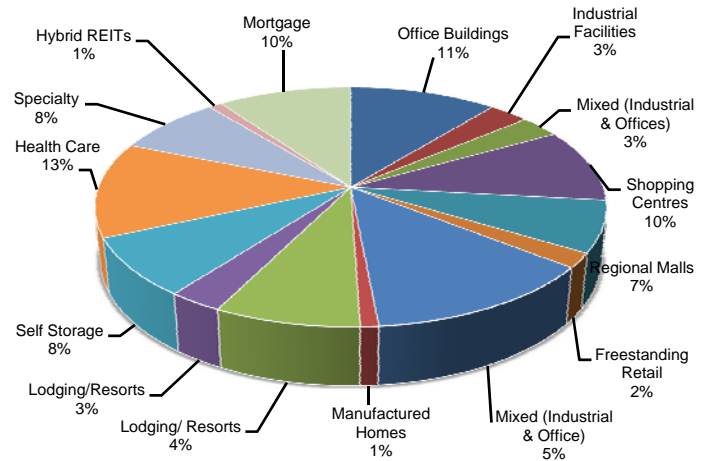


Figure 2: REITs Invest In All Property Types as Feb 28, 2009. Source: NAREIT.com

Japan: The Japanese REIT (J-REIT) was launched in 2001 and over a four year period the market grew ten times to \$19.9billion by 2005. REITs in Japan have been responsible for major and popular real estate developments in its key cities, with 15 REITs currently in operation. Japan's real estate market is seven times larger than it was three and a half years ago, with a potential to grow to a \$100billion industry in the next six years, according to Scott Crowe, Director and global real estate strategist with UBS Asset Management.

United Kingdom: REITs were first launched in January 2007 in the UK as a way to address the double taxation issues suffered by the listed property companies and to grow the pool of potential investors in the UK commercial property sector. Immediately upon the launch in January, nine UK property companies converted to REIT status.



REITs IN NIGERIA – THE "N-REIT"

In 2007, the Securities and Exchange Commission (SEC) issued the first set of guidelines for the registration and issuance of requirements for the operation of REITs in Nigeria is detailed in the Investment and Securities Act (ISA).

Market Update

Monday, March 27, 2009

Investors/Unit-holders	• minimum of 100 shareholders
REITs Assets	• minimum of 75 % of assets in Real Estate (including mortgage), government security, or cash
REITs Income	• minimum of 75% accrue from rent, mortgage or sale of property
REIT Revenue Distribution	• minimum of 90% to be distributed to unit holders

Figure 3: Key Requirements for REITs

The introduction of REITs, in Nigeria, will in the long term give investors value based investment options and provide the needed cheaper, long term funding to the real estate sector, which will in turn lead to the development of good quality property stock.

Nigeria's first REIT was the N2 billion Skye Shelter Fund, established in 2007 with the primary purpose of providing a pool of funds for real estate development. However, it lacked the tax advantage that is a crucial feature of a REIT. Skye Bank Plc, the main promoter underwrote 35% the offer, 15% more than the mandatory requirement (NAN).

Skye Shelter Fund Management Report for the 2nd Qtr ended 30-06-2008

Turnover	N150.383m
Profit before Taxation	N59.738m
Taxation	(N19.116m)
Profit after Taxation	N40.622m
Outstanding Units	20,000,000
Earnings per Share/Unit	N2.03
Market Price as at 31st March 2008	N105.00

Source: Nigeria Stock Exchange. Note: the company commenced operations in 2008

The Union Homes Hybrid REIT was launched last year, promoted by Union Homes Savings and Loans Plc. In spite of the announcement that it had received approvals as a tax transparent vehicle, the N50billion public offer was grossly undersubscribed. The failure was blamed on the timing of the offer which coincided with global market meltdown. However, insufficient transparency in terms of the REIT's investment strategy and intended portfolio composition may have also contributed to investor apathy.

THE FUTURE OF REITs IN NIGERIA

The success of the Union Homes REITs (and any other similar vehicle) on the Nigerian Stock Exchange will depend largely on the quality of its property portfolio, and by extension, the quality of its cash flows from rental income and sale. In turn, the portfolio itself requires strong asset, property and facilities management competences to create, maintain and grow in value.

REITs offer a great deal of opportunities as it provides cheaper and longer term capital for big ticket real estate transactions and broadens access to real estate ownership. However, the real estate sector will face certain challenges as REITs become more widely accepted.

The most prominent challenge is the lack of good quality property stock for purchase. This means that most REITs will carry additional

risk as a result of investing significantly in development/construction projects, in order to create stock for the portfolio.

The lack of real estate asset management and property/facilities management competence/expertise will in the medium term put a strain on operation of REIT vehicles. This presents opportunities for foreign expertise to establish local operations and partnerships in Nigeria.

The tedious process of acquisitions and sales will continue to be a major stumbling block, in addition to the exorbitant costs associated with the process. A review of the Land Use Act has been undertaken with a view to making the trading of real estate assets and ownership process easier. Although the details of the amendment have not been published, critics opine that the changes will not be sufficiently significant to make an impact on cost and time.

WHAT SHOULD HAPPEN NEXT

Though the development of REITs in Nigeria is still in its infancy, we expect an increase in acceptance of this investment vehicle because of the tremendous benefits it offers across the investing spectrum. For this to happen though, it is imperative that the Promoters and Managers of REITs are able to present vehicles which truly mimic similar vehicles across the world, particularly in the area of transparency of strategy and portfolio composition. In other REIT regions, promoters are able to present their portfolio of existing and pipeline properties, give full details of tenant profiles and portfolio revenue and expenses.

It should be possible for quoted property companies to convert to REITs, to take advantage of the single tax regime. Similarly, REITs will provide existing private real estate companies and similar holders of large real estate the opportunity to "go public" with ease, carving out an appropriate "investment grade" portfolio and receiving an equity release.

NEWS FLASH

LASG "AFFORDABLE HOUSING" IS NOT AFFORDABLE!!

A recent advertisement by the Lagos State Ministry of Housing is offering one and two bedroom flats for N5.5m (\$37,500) and N7.6m (\$52,500) respectively, in Ikorodu, on the outskirts of Lagos. According to the Ministry, the housing units are for "low income" earners. Using Affordability Criteria (culled from Prof. T.O. Nubi – HOD Estate Management, University of Lagos);

Value of Home:	N5.5m
Value of Mortgage:	N4.4m
Monthly Mortgage Repayment:	N37,500
Interest Rate:	12% pa
Length of Mortgage:	25yrs(300 months)

The buyer will have to earn N1.35m per annum in order to afford this property. Today, the minimum wage remains at N90,000 per annum!

In order to address affordability, housing units must be delivered significantly cheaper. Technology, leading to mass production is a clear way to deliver at a more affordable price point. On the buy side, micro-mortgage loans are an option that will enable the bottom of the pyramid gain access to financing for home ownership. In other parts of the world, creative solutions between financiers, building component manufacturers and government have been successfully used to overcome the inherent hurdles in viable affordable housing models. It is time to take a look at these case studies, learn, adapt and implement solutions which address our own problems.