

REITs Investor Guide



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN



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Introduction

In order to promote awareness about Real Estate Investment Trusts (REITs) which is still a naïve concept in the South Asian region, The Securities & Exchange Commission of Pakistan has formulated this guide to equip investors with the elementary knowhow regarding REITs in Pakistan. Being the first country to have established REITs in South Asia, the document provides information on structure, method of incorporation and relative advantages of investing in REITs.


What is a REIT?

Real Estate Investment Trust is a mutual fund that invests in properties and derives income from such investments for its unit holders.

A REIT Management Company (RMC) identifies a project and raises public money through an Initial public offering (IPO). The RMC then buys a property (in case of Rental REIT Scheme) and rents it out. The rent is then distributed to the unit holders (The shareholders of REIT Scheme are known as unit holders).

In case of a developmental REIT Scheme, a RMC identifies the project, raises public money through IPO, constructs and then either sells the project or rents it out. The money received due to sale or rent is distributed among the unit holders.

Globally, REITs are open-end structures. In Pakistan, initially closed-end structure has been introduced to mitigate high redemption risk. Moreover REITs in Pakistan have a trust structure. The main difference between a REIT fund and a mutual fund is that the underlying asset in case of a REIT fund is Real Estate. Moreover, REITs are flow through entities which are tax exempt provided the management company distributes at least ninety percent of the annual profit as dividend to the unit holders.



REITs are very diverse and are generally used to bolster investment activity in office buildings, residential property, shopping malls, hospitals, schools and industrial uses.

What is a REIT Scheme?

Under the REIT Regulations, 2008, a REIT scheme is a Real Estate Investment Trust having the following properties:

1. Closed-end scheme launched by the RMC
2. May be Developmental REIT Scheme and, Rental REIT Scheme or a Hybrid REIT Scheme
3. AREIT scheme is listed on the stock exchange

What is an RMC?

A REIT Management Company abbreviated as an RMC is licensed by the Commission as an NBFC to launch REIT Scheme and provide REIT Management Services. The RMC is licensed under the NBFC Rules, 2003 and is obligated to abide by the provisions of the Companies ordinance, 1984, NBFC Rules, 2003 and the REIT Regulations, 2008.

What Type of REITs are there in Pakistan?

In Pakistan there are three basic type of REITs:

1. Rental REITs

A Rental REIT scheme is established for the object of making investments in commercial or residential Real Estate with a purpose of generating rental income. In a Rental REIT, a fully constructed property is first bought by the RMC and than rented. The rental income derived through it is distributed to the unit holders.

2. **Developmental REITs**

In a Developmental REIT scheme, land is acquired by the REIT for the purpose of development of commercial, industrial, residential Real Estate through construction or refurbishment and subsequently sold or rented. The proceeds from sale/rent of the property are then distributed to the unit holders.

3. **Hybrid REITs**

REITs in Pakistan can also be a combination of Rental and developmental REITs and are known as Hybrid REITs.

Why REITs?

Typically, REITs provide investors with small capital base the opportunity to invest in Real Estate. Also, in periods of robust economic activity, an increase in the value of Real estate is reflected in REIT stocks that appreciate considerably. Moreover, being a flow through entity, REITs are tax exempt on distribution of ninety percent profits. This prevents double taxation as income derived from REITs is taxed only at the individual level.

What is the role of SECP in REIT industry?

SECP regulates REITs in Pakistan by formal notification of the REIT Regulations 2008. The objectives of SECP are to protect the interest of investors and to promote and develop the corporate sector and the capital markets.

How is REITs set up?

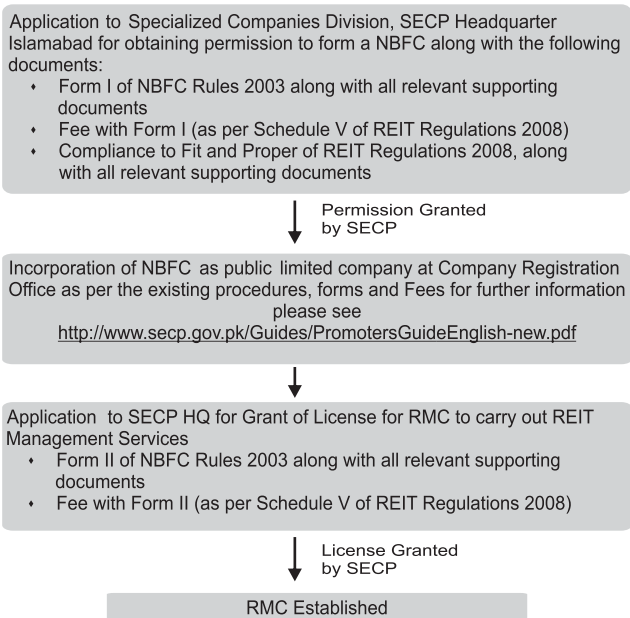
REITs in Pakistan have a trust structure. The trust form has trustees, the REIT Management Company (RMC) and investors. The trust is established by the REIT management company and the trustee. The trustees of the REIT fund hold its property and keep an eye on the

operations of a particular REIT Scheme. REIT Management Company (RMC) approved by SECP manages the scheme in accordance with the provisions of the trust deed and the offering document.

A flowchart showing the formation of an RMC is given her under:

Incorporation of RMC and Grant of License

The REIT Management Company (the “RMC”) is a Non-Banking Finance Company (“NBFC”) licensed by the Securities and Exchange Commission of Pakistan (“SECP”) to carry out REIT Management Services in accordance with Part VIII-A of the Companies Ordinance, 1984 (the “Ordinance”) and the REIT Regulations, 2008. RMC is to be incorporated under the Ordinance read with the provisions of the NBFC Rules, 2003. Following is the suggested chronological methodology for Incorporation of a RMC.



Does SECP approval mean that the REIT will be profitable and is considered safe?

No, all investments are prone to certain risks and the promulgators of REIT Scheme must apprise the investors of the risks involved. Furthermore, the REIT Regulations impose an obligation on the RMCs to disclose true and adequate information about the REIT scheme to enable investors to make an informed investment decision. Approval by SECP in no way guarantees the profitability or safety of the REIT Scheme. Therefore, investors must themselves assess the merits of investing in REITs vis-à-vis their investment objectives.

Role of the Trustee

The trustee acts as the custodian of the REIT assets and ensures that the REIT Scheme is managed according to the guidelines stipulated in the trust deed to minimize the risk of mismanagement by the RMC. The involvement of the trustee mitigates the risk of any malpractices that may be harmful for the interests of the unit holders and the general public at large.

What are the advantages of investing in REITs?

Professional Management of Real Estate - REITs is generally accepted as a symbol of quality as professional management of the assets ensures enhanced goodwill and better return on investment.

Low Beta and Consistent Returns - REIT stocks are generally less volatile and offer a more consistent stream of income.

Diversification - REITs also provide an opportunity of diversification of portfolio thereby supporting the generally accepted business notion of investing in different types of activities.

Affordability - REITs provide investors with a small capital base, the opportunity to invest in Real Estate. This makes REITs attractive for



this particular category of investors.

Liquidity - REIT units are less liquid and therefore less attractive for day traders and consequentially impede speculation.

What are the Associated Risks?

A major disadvantage with REITs is that they depend heavily on the price of Real Estate. Any slump in the prices of Real Estate would affect the value of this stock and conversely translate into losses for the individual. The homogeneous nature of REIT funds thus makes it a risky asset in contrast to mutual funds which invests in a variety of areas.

Another disadvantage with REIT stocks in Pakistan is that they are closed end funds and hence can only be traded on stock exchanges.

Also, REIT units are relatively less liquid and holders of such units usually tend to hold it throughout the life of the REIT. Moreover, investment in REITs is prone to the basic types of risks inherent in investing in any other type of stocks.

What is the difference between Closed End and Open End Funds.

Closed-end funds have a fixed number of issued shares traded on an exchange. They generally do not issue new shares after the close of the subscription period. Because the supply of shares is limited, the traded price of the closed-end fund will rise and fall depending on supply and demand, just like shares of other companies traded on an exchange.

Open-end funds are allowed to issue new units and existing units can be realized or redeemed on demand. As there is no limit to the fund size, the price of the units does not rise and fall in response to demand, but is dependent on the value of the fund's underlying assets.

What is a “Trust Deed”?

REIT Schemes are established by a trust deed. It is a legal document that sets out the working arrangement between the RMC, the Trustee, and the investors.

What is an “Offering Document”?

The offering document lists the investment objectives and restrictions, its characteristics, risk disclosure, fees, dealing procedures, as well as sources of further information.

How REIT Funds can earn money for you?

The money raised through issuance of units i.e. REIT Fund is utilized in either buying property or constructing property. The return to unit holder is received when the property is either sold or is rented out.

The unit holder receives the return on his investment either through dividend or capital gain. Usually when the property of REIT Scheme is rented out, the rent of the property is received which is then distributed to the unit holders in form of dividend.

Unit holders also can sell off the units in stock exchange if the price of the unit appreciates on the stock exchange. This is known as the capital gain on a unit. The price of unit increases either due to speculation or increase in net asset value (NAV).

What is Net Asset Value (NAV) of a REIT Fund?

Net Asset Value is the market value of the assets of the fund minus its liabilities divided by the number of units outstanding on the valuation date.

Can non-resident Pakistanis (NRPs) invest in REITs?

Yes, non-resident Pakistanis can also invest in REIT Schemes. Necessary details in this respect are given in the offering documents of the schemes.



How is the RMC compensated for its services?

The RMC is entitled to a remuneration of an amount as permissible by the SECP under the REIT Regulations, 2008.

Are returns from REIT taxable?

REIT Schemes distributing ninety percent of income as dividend are exempt from payment of income tax at Scheme level. The unit holders are subject to tax on dividend distribution by REITs at the applicable tax rates.

If REIT scheme is wound up, what happens to money invested?

In case of winding up of a scheme, the RMC managing the fund shall be liable to pay a pro-rata sum based on the proportion of investment in the fund at the prevailing NAV after adjustment of expenses.



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