

The Proliferation of Global REITs and the Cross-Borderization of the Asian Market

JULIUS L. SOKOL*

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“Buy Land, They’re Not Making it Anymore”

~Mark Twain

I. INTRODUCTION

To characterize the recent success of the real estate market as a boom is analogous to describing the stock market crash of 1929¹ as an economic downturn. It is no secret that during the last ten years, the United States real estate industry has developed at a revolutionary pace.²

1. It is interesting to note that there was no real estate boom during the stock market success of the early 1920's. In fact, even when the stock market crashed, home prices did not decline. The nominal price of homes, however, did drop as the Consumer Price Index fell. ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE*, 15 (2d ed. 2005).

2. Since the late 1990's U.S. home prices have increased dramatically. "There has been a 'rocket taking off' here Real home prices for the United States as a whole increased 52% between 1997 and 2004. The increase was higher in some areas of the United States and lower in others, but the fact that it was a 52% increase over all is remarkable. This is nothing like the tripling of the stock market between 1995 and 2000, but, when viewed in comparison with long-run historical patterns in home prices, it is still striking." SHILLER, *supra* note 1, at 12-13.

Between 2000 and 2003, for example, the percentage of “million-dollar homes” in the United States doubled.³ The increase in home values also spurred rapid development and construction growth during the first half of the decade,⁴ leading to increased jobs and economic maturation. Not only has the real estate revolution benefited large developers such as Lennar⁵ and Toll Brothers,⁶ growth and prosperity has extended to “do-it-yourself” construction retailers like Home Depot⁷ and Lowe’s.⁸ The remarkable success of these markets also permeated other branches of the industry, further perpetuating the real estate boom.

A brief look into recent property transactions, for instance, reveals that Realtors have enjoyed tremendous success throughout the country.⁹ Various media outlets have also done their part to propel the industry to the forefront of consumer marketing. The Internet, for example, is now

3. Press Release, U.S. Census Bureau, Median Hous. Values Continue to Rise, Census Bureau Reports (May 24, 2005), http://www.census.gov/Press-Release/www/releases/archives/american_community_survey_acs/004974.html.

4. In 2000, almost 1.6 million construction permits were issued. U.S. CENSUS BUREAU, ANNUAL DATA, NEW PRIVATELY OWNED HOUSING UNITS AUTHORIZED BY BUILDING PERMITS IN PERMIT ISSUING PLACES (2007), <http://www.census.gov/const/bpann.pdf>. By 2005, the number of issued construction permits had increased to nearly 2.2 million. *Id.* Such growth amounted to a 69% increase above the 1.3 million construction permits that were issued in 1995. *Id.*

5. Lennar’s stock price increased dramatically from a December 1997 adjusted close of \$9.11 to a December 2006 adjusted close of \$51.05, an increase of approximately 565%. Yahoo Finance, <http://finance.yahoo.com/q/hp?s=LEN> (enter date range “Jan. 01 1997 to Jan. 01 2007” and select “Monthly” button; select “Get Quote”).

6. The stock price of Toll Brothers Inc. increased almost 500% from an adjusted close of \$6.69 in December 1997 to an adjusted close of \$32.23 in December 2006. Yahoo Finance, <http://finance.yahoo.com/q/hp?s=TOL> (enter date range “Jan. 01 1997 to Jan. 01 2007” and select “Monthly” button; select “Get Quote”).

7. Home Depot’s stock price flourished over the last ten years increasing from an adjusted close of \$17.78 in December 1997 to an adjusted close of \$38.77 in December 2006. Yahoo Finance, <http://finance.yahoo.com/q/hp?s=HD> (enter date range “Jan. 01 1997 to Jan. 01 2007” and select “Monthly” button; select “Get Quote”).

8. Lowe’s also experienced phenomenal growth increasing over 500%, from an adjusted close of \$5.70 in December 1997 to an adjusted close of \$30.76 by December of 2006. Yahoo Finance, <http://finance.yahoo.com/q/hp?s=LOW> (enter date range “Jan. 01 1997 to Jan. 01 2007” and select “Monthly” button; select “Get Quote”).

9. From 1996-2006, membership in the National Association of Realtors increased by 75%; by 2006, the association had 1.2 million members. Stephen J. Dubner & Steven D. Levitt, *Endangered Species*, N.Y. TIMES MAG., Mar. 5, 2006, at 24, available at 2006 WLNR 3697516. In 2004, the average Realtor earned \$49,300, whereas in 1995 average earnings were only \$33,500, a 47% increase. Frederick Heller, *Field Guide to Realtor® Income*, REALTOR.ORG, <http://www.realtor.org/libweb.nsf/pages/fg103#topica> (last visited Mar. 5, 2007).

host to a plethora of highly utilized¹⁰ real estate sites,¹¹ while cable television has also carried on the trend, increasingly awash with home improvement and real estate reality shows.¹²

This incredible growth, however, has not been limited to the prosperity of direct real estate. Real estate securities, particularly real estate investment trusts (REITs), have also flourished at the domestic and international level, more than quadrupling their market capitalization since 1990.¹³ REITs have even emerged in Asia, where Hong Kong, Malaysia, Japan, South Korea, Singapore, and Taiwan now offer REIT structures. The market in this region has evolved at an unprecedented rate, amassing more than 80 individual REITs worth over \$77 billion in a matter of only seven years.¹⁴

With such rapid growth, it is no surprise that investors are flocking to Asian REITs¹⁵ hoping to reap the double-digit returns that have

10. A survey conducted by the National Association of Realtors showed that 71 percent of homebuyers used the Internet in their home search during the first quarter of 2003, a 73 percent increase from the 41 percent in 2001. BRIDGET MCCREA, *THE REAL ESTATE AGENT'S FIELD GUIDE* 31 (2004).

11. The real estate transaction "process has been streamlined by the Internet, which has created dramatic change both in the communications and in the transaction time itself." John Foltz, *Foreword* to BRIDGET MCCREA, *THE REAL ESTATE AGENT'S FIELD GUIDE* viii (2004). Even throughout the 1990's, the Multiple Listing Service (MLS) was only available to real estate agents. *Id.* at 4. In 2004, the MLS became available to the general public, allowing potential buyers the ability to access information about listings without the use of an agent. *Id.*

12. In 2005 alone, approximately twenty new shows debuted on HGTV, Fine Living, Discovery Home, A&E, and TLC. Teresa Wiltz, *TV's Hot Properties: Real Estate Reality Shows*, WASH. POST, Dec. 28, 2005, at C01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2005/12/27/AR2005122701018.html>. The show "House Hunters" averaged roughly one million viewers per episode while "Flip This House" drew an average audience of 802,000 viewers. *Id.* Such infatuation with real estate prompted these channels to schedule another seven shows for 2006. *Id.*

13. In 1990 the market capitalization of global REITs was \$150 billion. Steve Bergsman, *As REITs Go Global, Are Investors Ready to Go With Them?*, REAL EST. PORTFOLIO, Nov./Dec. 2005, available at <http://www.nareit.com/portfoliomag/05special/p16.shtml>. By 2005, that number was closer to \$609 billion. Ted Bigman & Christina Chiu, *The Case for a Strategic Allocation to Global Real Estate Securities*, MORGAN STANLEY INVESTMENT MGMT. J., Fall 2005, at 15, 21, http://www.morganstanley.com/im/resources/mkinsights/pdfs/msimjournal_2005_fall.pdf.

14. *Market Perspective*, ASIAN Q., (Prudential Real Est. Investors, Parsippany, N.J.) Oct. 2007, at 3, available at http://www.investmentmanagement.prudential.com/media/managed/documents/pim/Pru_Asian_Quarterly_Oct_2007.pdf.

15. For example, Steve Carrol, managing director of CB Richard Ellis Global Real Estate Securities, states that "There is an incredible amount of institutional investor capital flowing into Asia due to the advent of recent REIT legislation." Erin Corcoran, *Real Estate Leaders from Across the Globe Discuss Key Issues Facing the Industry*, REAL EST. PORTFOLIO, Jan./Feb. 2007, (quoting Steve Carrol), available at <http://www.nareit.com/portfoliomag/07janfeb/feat1.shtml>.

characterized these markets.¹⁶ Despite such popularity, however, Asian governments have failed to fully capitalize on the popularity of these regimes by maintaining overly burdensome regulations of their respective REIT markets. The laws are not only stringent, but also inconsistent from country to country, further stunting market growth. This hybrid problem of strict legislation and inconsistent cross-border regulations effuses an aura of instability and uncertainty among prospective investors and developers, subsequently limiting the flow of investment into the Asian REIT market. Since these regimes do not attract as much investment as they potentially could, the real estate securities markets in these countries have underperformed, and therefore been unable to realize their full potential.

This balkanized regulation of Asian REITs must be altered in order to ensure future growth within the industry. The governments within Asia must take a coordinated approach to lowering their restrictions on REIT formation, taxation, and operation. Such a methodology will undoubtedly help Asian REITs gain stability, in turn raising their level of attractiveness to outside investment. As investment increases and these REITs mature, investors will gain confidence in these markets, thereby benefiting other facets of the various Asian economies.

After a brief discussion on the history of REITs, this Article goes on to analyze their importance and role within the global and Asian economy. Next, the underlying motivations for legal amendments to the REIT structures are discussed, as well as the socio-economic benefits associated with coordinating liberal REIT legislation throughout Asia. Subsequently, this article analyzes the various regulatory aspects of the regimes in Japan, Singapore, Hong Kong, South Korea, Thailand and Malaysia. In exploring their shortcomings, comparisons are made to the highly successful United States REIT structure. Given the history of our nation's regime, it goes without saying that Asian REITs have a lot to learn in order to achieve maximum growth and future success.

16. Chris Reilly, *Asian REITs—Up and Running*, REAL EST. PORTFOLIO, Nov./Dec. 2005, available at <http://www.nareit.com/portfoliomag/05special/p40.shtml>.

II. WHAT ARE REITS?¹⁷

REITs are “publicly-traded companies which invest in and manage portfolios of commercial properties or mortgage loans.”¹⁸ They offer individuals and organizations the ability to invest “in real estate that was once the exclusive domain of the very wealthy and institutions.”¹⁹ REITs are an attractive asset class that offer investors the ability to invest in real estate while simultaneously benefiting from the liquidity of common stocks.²⁰ Perhaps most relevant to this discussion, however, is that REITs are legal entities empowered by corporate structures and favorable taxation guidelines.

REITs have not always been perceived as a viable real estate investment alternative. For years, investors believed that direct real estate was their only option.²¹ Direct real estate investment, however, has always been a rather exclusive undertaking, requiring financial capability, time, knowledge, and experience, characteristics that, for the most part, are not available to average investors. The exclusivity of this form of investment coupled with the uncertainty of some public markets²² seemed to discourage investors from all other forms of real estate investment. Those looking to invest their capital somewhere other than direct real estate instead opted for traditional investment vehicles such as stocks and bonds.

Until recently, even Wall Street and other investment experts avoided this long established, yet extremely viable, alternative to direct real estate investment.²³ These sentiments, however, began to erode in the mid-1990’s as the U.S. REIT market quickly grew from \$32 billion in 1993

17. Use of the term(s) REIT or REITs in this Article pertains exclusively to the most prominent form of REITs, equity REITs. This Article will not involve discussion of other REITs, namely mortgage REITs.

18. JOHN A. MULLANEY, REITS: BUILDING PROFITS WITH REAL ESTATE INVESTMENT TRUSTS 1 (1998).

19. *Id.*

20. RALPH L. BLOCK, INVESTING IN REITS 8 (2006). “REITs have provided individual investors all over the country with a way to buy skyscrapers and shopping malls and hotels and apartment buildings—in fact, just about any kind of commercial real property you can think of.” *Id.*

21. Direct real estate is the bricks and mortar of the industry, the direct and physical ownership of residential or commercial property.

22. BLOCK, *supra* note 20, at 93 (“[Direct] real estate investors harbored a distrust for public markets (REITs included), which they saw as roulette tables where investors put themselves at the mercy of faceless managers—or worse, speculators and day traders whose income depended on volatility. These investors saw REITs as highly speculative and wouldn’t touch them.”).

23. BLOCK, *supra* note 20, at 8 (“REITs have been around for more than forty years, but it’s only been in the past dozen years that most people have really started buying into these higher-yielding investments.”).

to \$138 billion in 2000.²⁴ By 2006, the U.S. REIT market was made up of 183 REITs with a market capitalization of \$438 billion.²⁵ Given this astounding growth, it is fair to say that within the United States, investors now see REITs as a viable investment option.

A. The Globalization of REITs

The greatest change in the real estate securities market arose in the global context, where over the last decade, REITs have expanded beyond United States borders to gain notoriety throughout the world. Steve Carroll, a managing director with CB Richard Ellis Global Real Estate Securities²⁶ states “[w]e are entering a new phase in ‘REITdom’ in that more and more investors are going to think about REITs from a global perspective because the model is becoming increasingly accepted worldwide . . . The investment universe is broader and opportunity is greater.”²⁷ Within the European Union, for example, the Netherlands, Belgium, France, Greece, Italy, and the United Kingdom²⁸ all maintain established REIT regimes.²⁹

24. NAREIT, HISTORICAL REIT INDUSTRY MARKET CAPITALIZATION: 1972–2006 (2008), <http://www.nareit.com/library/industry/marketcap.cfm>.

25. *Id.* Market capitalization, perhaps the best measure of REIT growth, represents the total dollar value of all outstanding shares. “Market capitalization is calculated by multiplying [the number of] shares outstanding by the current market price of one share.” Market Capitalization, INVESTOPEDIA.COM, <http://www.investopedia.com/terms/m/marketcapitalization.asp> (last visited Apr. 10, 2007).

26. CB Richard Ellis is the world’s largest commercial real estate services provider (based on 2006 revenue), with more than 300 offices worldwide and approximately 24,000 employees (excluding affiliate and partner offices). CB RICHARD ELLIS, ANNUAL REPORT 2006 2 (2006), available at <http://ir.cbre.com/phoenix.zhtml?c=17560&p=irol-reports> annual (select “2006 Annual Report”).

27. Bergsman, *supra* note 13 (quoting Steve Carroll).

28. James Aitken, *The Chancellor Gets it REIT*, THE J. ONLINE, July 2006, <http://www.journalonline.co.uk/article/1003222.aspx> (“After years of delay, the UK Government has finally confirmed that from January 2007 the UK will have its own form of real estate investment trusts”).

29. EPRA, EPRA GLOBAL REIT SURVEY: A COMPARISON OF THE MAJOR REIT REGIMES IN THE WORLD 5 (Loyens & Loeff eds. 2004), available at http://www.epra.com/media/EPRA_Global_REIT_Survey.pdf; see also Fraser Hughes, *The Long Road to a Pan-European REIT*, REAL EST. PORTFOLIO, Nov./Dec. 2005, available at <http://www.nareit.com/portfoliomag/05special/p32.shtml>. Italy formed their regime in 1994, followed by Belgium in 1995 and France in 2003. EPRA *supra*, at 7. The United Kingdom recently introduced their regime in January of 2007. NABARRO NATHANSON, HOW TO BECOME A UK REIT 6 (2006), <http://www.londonstockexchange.com/NR/rdonlyres/85988E28-A6DA-4225-945F35D7941EC732/0/HowtobecomeaUKREIT.pdf>.

Countries in Asia have also caught on, with Japan, Hong Kong, South Korea, and Singapore all instituting REIT legislation over the last seven years.³⁰ Globally, there are now 484 publicly traded REITs with a market capitalization of \$608 billion.³¹ With new regimes being implemented yearly, analysts believe that the global market has no plans of slowing down.³² In fact, some predict that the global market will reach \$1 trillion within five years.³³ James Corl, Chief Investment Officer of Cohen & Steers Inc.,³⁴ states:

The globalization of REITs is a fantastic phenomenon. . . . It is going to stimulate more interest in real estate in general. Real estate is under-weighted in just about everyone's portfolio, including both domestic and international investors, so the creation of REITs in other countries will draw investment dollars from the U.S. as well as from other countries. It is going to open up the investment class to investors that have never really been able to tap into REIT investments before. More demand will be created everywhere.³⁵

The emergence of this global market is indicative of the movement away from U.S. REITs towards a more international investment strategy. The trend has only just begun, and with many options already available, future investors and developers will surely look to maximize their portfolios by investing in the most efficient and stable regimes.

30. Japan led the way in 2000, followed by South Korea in 2001, Singapore in 2002, and Hong Kong in 2004. EPRA, *supra* note 29, at 27.

31. Press Release, Ernst & Young, With an Estimated Mkt. Cap of US\$600bn and Rising, Global REIT Mkt. Comes of Age (Oct. 30, 2006), http://www.ey.com/global/content.nsf/International/Press_Release—Global_REIT_Survey_2006.

32. Steve Carroll, Co-Chief Investment Officer at CD Richard Ellis Global Real Estate Securities, states that "'We don't think the U.S. REIT market is played out; it will continue its upward growth' 'But we think the growth will escalate at a much more rapid pace overseas as more markets become securitized.'" Vivian Marino, *A Coming of Age for the Global Real Estate Market*, N.Y. TIMES, Jan. 7, 2007, at 3 (quoting Steve Carroll), available at 2007 WLNR 302642.

33. "The introduction of Real Estate Investment Trusts (REITs) in the UK from January 2007 looks set to help the overall market for global REITs reach the \$1 Trillion mark in the next five years, according to Fidelity International." Press Release, Fidelity, Introduction of UK REITs Set to Spur Growth in Global REITs Mkt., Says Fidelity Int'l (Nov. 3, 2006), https://www.fidelityinstitutional.com/assets/pdf/061103_REITs.pdf.

34. Over the last twenty years, Cohen & Steers has grown into one of the industry leaders in the REIT market. As of 2006 the firm had just under \$30 billion in assets under management. COHEN & STEERS, ANNUAL REPORT 2 (2007), available at http://www.cohenandsteers.com/downloads/CnS_2007_AnnualReport.pdf.

35. Bergsman, *supra* note 13 (internal quotation marks omitted). Cohen & Steers is one of only a handful of companies offering investment in global real estate. In 2005, their Realty Fund was valued at \$153 million. *Id.*

B. The Asian REIT Market

Although the European regimes have developed quickly—by 2006 there were 90 REITs with a market capitalization of \$130 billion³⁶—REITs in Asia have emerged at an even faster rate. By the end of 2006, the Asian REIT market had grown to 83 REITs with a market capitalization of \$77 billion.³⁷ Though only a fraction of the hefty U.S. market, these regimes have grown at a tremendous speed in a matter of only seven years and have become known as “the hottest new asset class in Asia.”³⁸

Because of the popularity of real estate securities, some analysts believe that the Asian REIT market has the potential to double capitalization by 2010.³⁹ With such spectacular growth in limited time, there is no question that Asian REITs are well positioned to play a vital role in the global market. However, in order to achieve long-term success and attract future investment, this growth must be sustained by ensuring that the legislative framework enabling these REIT regimes remains friendly to investors and developers.

Because the introduction of REITs into the Asian economy was unfamiliar territory, early legislation was designed more to prevent financial loss than to encourage growth.⁴⁰ With investors now beginning

36. Matt Hudgins, *The Global March of REITs*, NAT'L REAL EST. INVESTOR (2006), http://nreionline.com/news/Global_REITs/.

37. *Market Perspective*, *supra* note 14, at 3.

38. Assif Shameen, *The Day of the REIT Dawns in Asia*, BUS. WK. (INT'L ED.), Nov. 1, 2004, at 46 (internal quotation marks omitted), available at http://www.businessweek.com/magazine/content/04_44/b3906147_mz035.htm. Equally as impressive, at the end of 2005, the 40 REITs in Asia had a total market capitalization of \$30 billion. HENDERSON GLOBAL INVESTORS, REITS IN ASIA—WHERE ARE THEY GOING? (2006), http://www.hendersongroupplc.com/content/Singapore/restricted/documents/propertynewsletter/2006-01_reitsinasiawherearetheygoing.pdf.

39. See Corcoran, *supra* note 15.

40. “The first and most important hurdle for REITs in a new market is to gain the support of local authorities in the formulation of a positive REIT legislative framework. However, REITs were traditionally perceived cautiously by the governing authorities in Asia, who were wary that the vehicle would be used to bail out owners of distressed properties at the expense of unsophisticated local investors. The caution on the part of the authorities was reinforced, since initiatives to introduce REITs often coincide with a downturn in the economy and real estate markets. As a result, the formulation of a REIT framework generally involves a lengthy process of lobbying, consultation and deliberation with the various stakeholders.” Joseph T. L. Ooi, et al., *The Growth of REIT Markets in Asia*, 14 J. REAL EST. LIT. 203, 213 (2006).

to notice the financial prowess of these regimes,⁴¹ Asian governments must make their best efforts to capture this growth. This can best be achieved by moving away from restrictive legislation and towards a more investor-friendly environment that is better suited for attracting investment. In other words, efficient growth cannot be achieved without the proper promotion of these regimes. Amendments of REIT laws will consequently play an important role in determining whether future investors consider Asia a formidable arena for real estate investment.⁴²

III. WHY SHOULD ASIAN GOVERNMENTS FOCUS ON REIT GROWTH?

While Asian REITs have certainly experienced growth over the last few years, their relevance from a political standpoint may be questioned. After all, most Asian governments encounter domestic concerns of greater importance than those associated with amending the laws of an international investment vehicle.⁴³ Two distinct circumstances, however, suggest that it is imperative for Asian governments to reform their REIT laws.

First, stringent REIT laws have recently stalled industry growth and effectively caused an undercapitalization of the market. A legislative

41. Cohen & Steers, an industry leader, now offers the Asian Pacific Real Estate Securities Strategy. They believe that “the Asia Pacific markets offer the potential for superior returns based on the region’s structural changes in securitization, variations in regional and national economic and property sector cycles, the diversity of business models, scarcity of sell-side and buy-side research coverage and the lack of uniform reporting and disclosure standards.” Press Release, Cohen & Steers, Asia Pac. Real Estate Sec. Strategies (Dec. 31, 2006), http://www.cohenandsteers.com/downloads/cns_asia_pacific_realtyTotalReturn2006Q4.pdf.

42. “Asian government plays the most crucial role in establishment and development of Asian REITs. The different results between two cases: the case in Singapore, whose government promoted the REITs progressively; the other case in Hong Kong and Korea, whose government put more restrictive rules on REITs at initial stage, clearly eviden[ce] that a REITs legislative environment will impact the development of REIT market greatly. Gaining the lessons from this point, it is suggest[ed] that Asian governments should review the REIT legislation and provide more favourable regulations, such as: allow tax transparency and overseas investment, comfortable gearing limitation, flexible management structure, and so on.” Wu Yue, *The Development of REITs in Asia*, PAC. RIM REAL EST. SOC. CONF., Jan. 22-26, 2006, at 16, http://www.pres.net/papers/Yue_Development_REITS_in_Asia.pdf.

43. Ongoing health issues, for example, have presented the need amendments to public health policy. “The Asia-Pacific region is confronted with several emerging health related issues resulting in deterioration in its health indicators despite the economic progress of some countries. The high level of deaths due to diseases and the burden of diseases is striking. Over 30 million people in the region died of preventable diseases in 2002.” Amarakoon Bandara, *Emerging Health Issues in Asia and the Pacific: Implications for Public Health Policy*, 12 ASIA-PAC. DEV. J. 33, 33 (2005), available at http://www.unescap.org/pdd/publications/apdj_12_2/bandara.pdf.

amendment is required⁴⁴ so that Asian REITs may prosper and avoid economic downturns that cause instability and decrease investor confidence. Second, Asian governments must amend their REIT laws so as to attract the plethora of eager investors that presently exists. Globally, the amount of money available for investment is greater than ever, and in order to stay competitive internationally, Asian REITs must attract investors by creating beneficial laws that provide consistent and efficient returns. An in-depth examination into these circumstances is critical to justifying the amendment of REIT laws.

A. Recent Market Slowdown

Despite superior performance early on, Asian REITs have recently encountered a brief slowdown in their growth.⁴⁵ The regimes have struggled because of under capitalization⁴⁶ and a lack of cross-border REIT growth. Cross-border REITS are those that maintain stock exchange listings and usually own property in more than one nation. These two characteristics have effectively stymied the growth of the Asian REIT. Because only a small portion of Asia's investment grade property is actually owned by REITs, the market is easily susceptible to the changing economic environment.⁴⁷ When a REIT controls fewer properties, fluctuating prices have a greater effect on the portfolio because there is less diversification than in a larger grouping.

For example, it is estimated that in Asia only 4% of property of investment grade property is under REIT ownership, whereas in Australia,

44. "As the Asian REIT at his [sic] early age of growing, it is absolutely necessary to have strong legislative framework that allows and supports the development of REITS. This includes favourable regulations with fewer restrictions on real estate investment, taxation and gearing. Specific designed incentives such as exemption from property related taxes and fees would also help the growth of this industry. Otherwise, legislative restrictions will limit and obstruct the development of REIT. It can be easily evidenced from the evolution of REITs in US and Australia, and the short history of Asian REIT market as well." Yue, *supra* note 42, at 7.

45. "Although the Asia REIT market began with high expectations last year, its performance was disappointing compared to other regions because of the lower-than-expected performance of the Hong Kong REIT market . . ." Jackie Lin, *Latest S&P Report Upbeat about Asian REIT Market*, TAPEI TIMES, Feb. 7, 2007, at 12, available at <http://www.taipeitimes.com/News/biz/archives/2007/02/07/2003348073>.

46. "The key opportunity for Asian REITs is that the total capitalization of Asian REITs is still quite small, comparing to mature REIT market in US and Australia, the nascent Asian REITs market still have room for further growth." Yue, *supra* note 42, at 13.

47. *Id.* at 15.

for instance, that number is closer to 50-60%.⁴⁸ The United States, however, maintains a more attainable level with 18% of investment grade property owned by REITs.⁴⁹ Since the trusts own relatively few assets, the circumstances in Asia cause the REITs to have a low market capitalization. As long as market capitalization stays low, investors will fear that Asian REITs are an unstable investment due to their inability to increase portfolio assets. Such an investment environment creates uncertainty and hurts the economy.

Asian governments must, therefore, amend laws to facilitate the expansion and growth of the REIT market. Relaxing current regulations will promote these regimes to new and foreign REITs and encourage existing ones to acquire additional assets, thereby increasing market capitalization and making more shares available for investors. Without a welcoming regulatory environment, REITs and their conduits will have no incentive to increase their property portfolios.

To date, Asian nations have struggled with this aspect, each maintaining laws that are not only restrictive but that also differ across borders. Although the legal provisions of each regime developed rather simultaneously, each structure is quite different.⁵⁰ These inconsistencies have proven to be significant barriers to interstate REIT formation because of the cost of compliance. When laws are too restrictive or differ greatly from country to country, the likelihood that a REIT will be listed “across borders” decreases greatly: “The result is confusing for REIT practitioners and investors and ultimately hinders cross-border activity among REITs and prevents the efficient flow of investment funds across markets by investors.”⁵¹

It is imperative for Asian governments to realize that cross-border REITs are the key to attracting trusts with large market capitalizations and encouraging existing ones to increase their property portfolios. Maintaining consistent laws will allow REITs to expand across borders and properly diversify their portfolios. This topic has a far-reaching effect and will be discussed in-depth later in the article.

B. Capital Heavy Investors Looking for Overseas Options

Although the growth of Asian REITs hinges on the ability of governments to restructure applicable laws, the role of investors cannot be overlooked. After all, a REIT regime, like all other investment vehicles, cannot thrive without investor support.

48. *Id.* at 13; *see also* Lin, *supra* note 45.

49. Yue, *supra* note 42, at 13.

50. HENDERSON GLOBAL INVESTORS, *supra* note 38.

51. *Id.*

Fortunately for the investment world, capital is currently in abundance, and investors are looking for viable ways to diversify their portfolios and increase returns.⁵² In an attempt to capitalize on the success of foreign markets, analysts and fund managers have also begun to steer their clients towards overseas investments, particularly when recommending real estate securities.⁵³ With such exuberance from the investment world, there is little doubt that demand for global REITs is at a high.

The Asian markets must, therefore, increase their efficiency in order to accommodate and attract the exorbitant amount of capital and wealth emanating from the United States⁵⁴ and the rest of the world.⁵⁵ In the

52. With 77 million retiring baby boomers on track to collect well above \$30,000 a year investment advice has been easy to come by: "Given the U.S. fiscal mess, investing abroad is a good idea. Try to avoid inflation-sensitive investments, like long-term bonds, and other potential traps, including waiting to withdraw your 401k balances until after tax rates have risen. You may also want to purchase real estate, commodities and collectibles that should retain their purchasing power over time." Laurence J. Kotlikoff, *The Time to Plan is Now*, TIME, July 10, 2006, at A26.

53. Ted Bigman, head of Global Real Estate Securities at Morgan Stanley, states that "[g]iven the benefits of international real estate investing, as well as the significant growth potential of global real estate markets, investors should invest in regions and securities that offer not only attractive yields but also the best total return opportunities. After all, though income returns are important, total returns should be the ultimate objective for portfolio performance." Ted Bigman & Christina Chiu, *The Case for a Strategic Allocation to Global Real Estate Securities*, PREA Q., Fall 2004, at 1, 6, available at <http://www.morganstanley.com/im/resources/mkinsights/pdfs/glireits.pdf>; see also Nicholas Yulico, *Global REITs Gain Attention*, THESTREET.COM, Mar. 21, 2006, <http://www.thestreet.com/markets/realestate/10274867.html> ("With concern that U.S. REITs are getting too hot, international real estate stocks are touted as a means to diversify, reduce risk and boost returns."); Bergsman, *supra* note 13 ("The common theme among companies that organize funds for the purpose of investing in publicly traded real estate securities is that globalization portends unlimited movement of capital among a wider range of geographic regions.").

54. In 2004 there was a record 8.2 million U.S. households with a net worth of more than \$1 million (excluding primary residences), a 33% increase over the 6.2 million U.S. households achieving this mark in 2003. Jeanne Sahadi, *Record High Number of Millionaires*, CNNMONEY.COM, Nov. 16, 2004, http://money.cnn.com/2004/11/16/pfi/millionaire_households/.

55. The 2006 World Wealth Report, compiled by Merrill Lynch & Co. and the Capgemini Group, reported that "[a] brief look back at key findings of our earlier reports shows how far HNWI [(High Net Worth Individuals)] wealth, the global economy and the wealth management industry have advanced during the past decade and how significant an effect global economic forces have on them: Overall, from 1996 to 2005, HNWI wealth grew at an annual rate of 8.0%, expanding from US\$16.6 trillion in 1996 to US\$33.3 trillion in 2005. Looking more closely, from 1996 to 2000, when HNWI wealth grew at an annual rate of 12.9%, and from 2003 to 2005, when it advanced by 8.1% annually, the world economy also experienced robust expansion." MERRILL LYNCH & CO. & CAPGEMINI GROUP, 2006 WORLD WEALTH REPORT: 10TH ANNIVERSARY 1997-

United States, “baby boomers” (individuals born between 1946 and 1964) are just becoming empty nesters and are starting to plan their inevitable retirement.⁵⁶ With the boomers receiving inheritances from their aging parents, this demographic will receive an estimated \$10 trillion in transferred wealth over the next eighteen years.⁵⁷ In addition, 80% of individuals over the age of sixty-five own mortgage-free homes.⁵⁸ Consequently, baby boomers will maintain both equity and excess funds. Rather than putting the money in the bank for a less-than-generous 2% return, experts have been urging baby boomers to look for greater returns in the REIT market.⁵⁹

Unsurprisingly, the conditions in Australia are not much different. There, the four million baby boomers account for roughly 40% of the nation’s wealth.⁶⁰ As these baby boomers age and plan their retirement, they will look for new vehicles to invest their accumulated wealth. An efficient Asian market would certainly offer an enticing and viable option to these investors as well.

Many investors have also turned to the purchase of secondary homes as a way to expand their real estate portfolios. For instance, in the United States 40% of all home sales in 2005 were purchased as second homes.⁶¹ Approximately 28% of second homes were purchased as investments, and another 12% were bought to serve as vacation retreats.⁶² This quick growth, however, can be seen as a reaction to the introduction of the 1997 capital gains tax exemption.⁶³ However, experts believe that the U.S. market for secondary homes will slip to 30% as interest rates rise, lending standards tighten, price appreciation slows, and speculative investors exit the market.⁶⁴

2006 2, (2006) available at http://www.us.capgemini.com/DownloadLibrary/files/Capgemini_FSI_WWR06.pdf. Globally, 8.7 million people hold more than \$1 million USD in financial assets, with \$33.3 trillion USD in total wealth among HNWI. This number is expected to increase to \$44.6 trillion USD by 2010. *Id.* at 4.

56. Chana R. Schoenberger, *Movin’ On Up: Boomers Reshape Real Estate*, FORBES.COM, Nov. 19, 2002, http://www.forbes.com/2002/11/19/cz_cs_1119housing.html.

57. *Id.*

58. *Id.*

59. Experts suggest that investors might decide to forgo buying homes and instead invest in REITs which offer higher returns and have a low correlation with both the S&P 500 and the Nasdaq indexes. *Id.*

60. Lisa Mulhall, *Marketing to the “Me Generation,”* PRIORITY, Issue 10, available at http://www1.auspost.com.au/priority/index.asp?issue_id=11&area=features&article_id=238 (last visited Apr. 17, 2008).

61. Noelle Knox, *Second Homes 40 Percent of Market*, USA TODAY, Apr. 5, 2006, at 1A.

62. *Id.*

63. *Id.* A 1997 change in the tax code provided favorable exemptions on capital gains, including gains from home sales. *Id.*

64. *Id.*

These statistics show that not only are investors looking for outlets to put their money but that they still have confidence that in real estate is a viable investment. With the domestic real estate market apparently stabilizing, overseas investment simplifying, and financial planners looking abroad, potential investors will likely be looking at real estate securities as a practical option. In addition, with global REITs on the rise, Asia is certain to be a potential conduit of investment.

Large cash and equity resources maintained by investment banks and holding companies are also poised to serve as catalysts for overseas investment. In 2006, for example, investment banks had a record year, increasing revenues by 33% to \$289 billion, with profits totaling over \$90 billion.⁶⁵ In addition, corporations have also continued to expand their business investment abroad. In 2004, the United States foreign direct investment outflows increased to a record high of \$229 billion, up from approximately \$120 billion in 2003.⁶⁶

Nonetheless, what remains important is that U.S. corporations are continuously looking abroad to expand their businesses and operations. It is only a matter of time before individuals, small companies, investment banks, and financial institutions follow suit and make foreign investment a critical component of all portfolios. With these trends, the next logical step for real estate savvy investors is to pursue real estate securities overseas where the market continues to expand and the profits are still growing. Asian governments must, therefore, take advantage of this surplus of capital to help boost their economies and establish their role within the international REIT world. Drafting laws that entice investors to place money in the Asian market as opposed to a regime in Europe or

65. THE BOSTON CONSULTING GROUP, MARKET REPORT FOURTH QUARTER 2006—INVESTMENT BANKING AND CAPITAL REPORTS 2 (2007), available at http://www.bcg.com/publications/files/Investment_Banking_Capital_Markets_Q4_06_Mar2007.pdf (stating revenues are expected to reach \$335 billion by 2007).

66. UNCTAD, WORLD INVESTMENT REPORT 2005: TRANSNATIONAL CORPORATIONS AND THE INTERNALIZATION OF R & D xix (2005), available at http://www.unctad.org/en/docs/wir2005_en.pdf. Typically, foreign direct investment figures reflect corporate activities such as building plants or establishing subsidiaries in foreign countries, and buying controlling stakes or shares in foreign companies. ROBERT D. ATKINSON & RANDOLPH H. COURT, *Foreign Direct Investment is on the Rise Around the World, in THE NEW ECONOMY INDEX: UNDERSTANDING AMERICA'S ECONOMIC TRANSFORMATION* 12 (1998), <http://www.neweconomyindex.org/NewEconomy.pdf>. Furthermore, short-term capital flows, such as portfolio investments of mutual funds, are not included in foreign direct investment figures. *Id.*

the United States, will enhance the Asian market and contribute much-needed stability.

IV. REIT SUCCESS IS LONG-TERM AND THE ASIAN MARKET MUST CAPITALIZE

Given the recent success of REITs and the excessive amount of available investment capital, few would argue that there is great potential for economic growth. However, why should Asian governments undertake the daunting and no doubt expensive task of amending REIT legislation? Perhaps legislators believe that it is not worth the region's efforts and REITs will never enjoy the type of success that they have in the United States. It is important to examine the historical performance of REITs to understand their benefit from an investment perspective.

For years, REITs have performed beyond expectations, providing investors with a valuable portfolio tool. Their popularity is only now reaching the global community. Asian governments must take advantage and amend laws in order to attract investors that would otherwise look to REIT regimes in other regions. Although in past years they garnered little fame among Wall Street connoisseurs, REITs are time tested investment vehicles that have only begun to show their potential. Asian governments can rest assured knowing that their attention is focused on a long-term investment vehicle.

The following sections serve to demonstrate why REITs have been able to achieve long-term financial success and become mainstays in investment portfolios.

A. Eager Investors Have Focused on REITS and the Trend is Likely to Continue

Although some in the investment world may question the importance of REITs, the majority of analysts have in recent years come to embrace what was once a forgotten⁶⁷ asset class.⁶⁸ Many commentators believe

67. "Although the first REIT was created in 1963, they played a very limited role in real estate investment until about 10 years ago, because there were not many available and also because they were widely misunderstood. In fact, they were largely ignored by stock investors as real estate and by real estate investors as stock." Judy Friedel, *REITs—An Investment for Income and Growth with Little Risk Attached*, PITTSBURGH BUS. TIMES, Jan. 10, 2003, available at <http://www.bizjournals.com/pittsburgh/stories/2003/01/13/focus7.html>.

68. "REITs . . . have returned an annualized 25% the past five years. Those returns are practically in the same league with those of tech stocks before they fell off a cliff starting in 2000. By contrast, Standard & Poor's 500-stock index has delivered only an annualized 8% over the past five years." Steven Goldberg, *Will REITs Crash?*, KIPLINGER.COM, Feb. 6, 2007, <http://www.kiplinger.com/columns/value/archive/2007/va0206.htm>. "REITs

that REITs are important investment vehicles for three reasons: they bear little correlation to the S&P 500, they have relatively low volatility, and they consistently reward investors with double-digit annual returns.⁶⁹ For these reasons, the popularity of REITs is sure to continue and Asian governments must take the proper steps to ensure that their regimes are available to investors looking to take advantage of this useful asset class.

1. As Low Correlated Assets, REITs Offer Investors Diversification

Basic investment strategy proffers that investing in only one asset class or in similar asset classes can prove to be a recipe for disaster.⁷⁰ Harry Markowitz, winner of the Nobel Prize for Economics in 1990, created what is known as the Modern Portfolio Theory.⁷¹ The theory holds that “a diversified range of assets will produce not only more consistent, but also better returns over time than contending ways of running a portfolio, namely securities selection and market timing.”⁷² Each investment in a portfolio must “display return attributes that are sufficiently different from those of other investments.”⁷³ The correlation of assets is therefore crucial to the success of an investment portfolio.

“Correlations measure how much predictive power the price behavior of one asset class has on another to which it’s compared.”⁷⁴ They are calculated on a scale of +1.0 to -1.0, where two asset classes with a +1.0 correlation will move in total unison, while two asset classes with a -1.0

and other commercial real estate investments have grown in popularity, not just among individuals looking for plump yields, but among all manner of institutional investors, including pension funds and large corporations.” *Id.*

69. BLOCK, *supra* note 20, at 10-14; *see also* Bigman & Chiu, *supra* note 13, at 16, 21; IBBOTSON ASSOCIATES, STOCKS, BONDS, BILLS AND INFLATION 2006 YEARBOOK 57-59 (Michael W. Barad ed. 2006); *but see* Bigman & Chiu, *supra* note 13, at 18 (stating that REITs still have greater volatility than direct real estate investment).

70. For example, “if you had put all your money into Nasdaq stocks in March 2000, you would have had 21.6% of it of it by October 2002. You would have had 46.3% of it now[, Jan. 2007].” Chris Cleary, *Investment—Putting a Portfolio Together*, J@PAN INC., Winter 2006, at 24, available at http://www.japaninc.com/mgz_winter_2006_portfolio.

71. *Id.* (“Markowitz suggested that asset allocation accounts for approximately 90% of portfolio performance on a risk-adjusted basis, a figure that has been borne out repeatedly by subsequent studies . . .”).

72. *Id.*

73. NAREIT, PORTFOLIO DIVERSIFICATION THROUGH REITS (2006), http://www.nareit.com/epubs/2006_Ibbotson.pdf.

74. BLOCK, *supra* note 20, at 11.

correlation will move in complete opposite directions.⁷⁵ An investor who properly maintains a diverse portfolio of low correlated assets will avoid excessive losses and secure a stable position for long term growth.⁷⁶

Empirical data consistently shows that REITs bear little correlation to other popular asset classes such as the S&P 500 and government bonds.⁷⁷ For instance, from 1992-2004 the correlation of monthly REIT returns to large-cap stock returns was 0.26, while the correlation of bond returns was 0.01.⁷⁸ The results of a 2005 Ibbotson analysis⁷⁹ produced perhaps the most compelling pro-REIT evidence. The study found that if an investor's portfolio from 1972-2004 consisted of 50% stocks, 40% bonds, and 10% T-bills, the annual return would be 10.9% with an overall portfolio risk of 10.6%.⁸⁰ On the other hand, if during the same time period, an investor's portfolio consisted of 40% stocks, 30% bonds, 20% REITs, and 10% T-bills, the annual return would be 11.6% with a decreased portfolio risk of 10.1%.⁸¹

An in depth investigation into the performance of various asset classes displays comparative results. In 1998 and 1999, for instance, REITs posted returns of -18.82% and -6.48% while the S&P 500 produced

75. *Id.* "For example, if the correlation of an S&P 500 index fund with the S&P 500 index is complete, that is, 1.0, then a 2 percent move in the S&P 500 index would predict that the move in the index fund for the same period would also be 2 percent." *Id.* A correlation of 0, on the other hand, establishes that the relationship between the two classes is random. Marc D. Stern, *The Power of Low-Correlation Investing*, CPA J., Nov. 2003, at 43.

76. In investing, a low correlation means that different asset types have not performed in the same way: "When returns on some asset types decline, returns on others decline less, or indeed gain. For investors, this diversification has obvious benefits. If poor performance in one investment can be offset by better (or even good) performance in another, extreme losses in an overall portfolio will be rarer than otherwise, and the capital will grow more in the long run." Stern, *supra* note 76, at 43.

77. "According to the most recent update of Ibbotson Associates' diversification analysis, REIT stocks boost a portfolio's total return performance over time because of the low correlation of REIT returns with those of other stocks and bonds[.]" *Developments: REIT Reality*, REAL EST. PORTFOLIO, Sept./Oct. 2006, <http://www.nareit.com/portfoliomag/06sepoct/dev6.shtml>.

78. *REIT Reality: Did You Know?*, REAL EST. PORTFOLIO, Nov./Dec. 2005, <http://www.nareit.com/portfoliomag/05novdec/reit.shtml> (this is a significant decrease from the period between 1972-1984 where the numbers were .63 and .19, respectively).

79. Ibbotson Associates, a subsidiary of Morningstar U.S., "is a leading authority on asset allocation with expertise in capital market expectations and portfolio implementation." *Ibbotson Associates—Overview*, MORNINGSTAR U.S., <http://www.ibbotson.com> (last visited Mar. 29, 2008).

80. *REIT Reality: Did You Know?*, *supra* note 78.

81. *Id.* Similarly, a portfolio with 45% stocks, 35% bonds, 10% T-bills, and 10% REITs, would have produced an annual return of 11.2% with a portfolio risk of 10.3%. *Id.*

28.58% and 21.04% returns.⁸² Likewise, in 2000 and 2001, REITs earned returns of 25.89% and 15.50% while the S&P 500 struggled with -9.11% and -11.88% returns.⁸³

Such statistics and data paint a very clear picture: REITs are decisive elements in the investment world. Their utilization enables investors to protect against excessive losses while maintaining the long-term growth that has been linked to a diversified portfolio. A low correlation to other asset classes is clearly a vital tool for portfolio growth and Asian governments must make the proper amendments to ensure that their regimes receive due consideration from investors.

2. The Low Volatility of REITs Reinforces Their Stability

The volatility of a stock represents how its price fluctuates from day to day.⁸⁴ With regard to REITs, volatility is important because it affects how investors view REITs on a daily basis.⁸⁵ For example, if a stock's price fluctuates significantly on a daily basis, the stock is said to have high volatility. On the other hand, if the price remains relatively stable, the stock has low volatility.⁸⁶ For some, investing is an emotional ordeal, so investments that fluctuate in price and cause investors to panic are not as attractive as those that are relatively predictable. The presence of low volatility, therefore, plays a crucial role in retaining investors over the long term.

REIT commentator and two-time author, Ralph Block, contends that "there is predictability and steadiness to most REITs' operating and financial performance from quarter to quarter and from year to year, and there is simply less concern about major negative surprises that can stoke volatility."⁸⁷ The volatility of a stock may also be expressed

82. NAREIT, CHART BOOK: A SUMMARY OF TRENDS IN THE PUBLICLY TRADE REAL ESTATE INDUSTRY AND THE U.S. REAL ESTATE ECONOMY (2008), available at <http://www.nareit.com/library/performance/CB0801.pdf>.

83. *Id.*

84. BLOCK, *supra* note 20, at 14.

85. *Id.* ("Our biggest investment mistakes are emotional ones. When our stocks are going up, we tend to throw caution to the wind in our pursuit of ever greater profits. Likewise, when our stocks are dropping, we tend to panic and dump otherwise sounds investments, because we're afraid of ever greater losses. . . . Prudent investors have learned through experience to temper their emotional reactions, but low volatility in a stock can make patient and disciplined investors of us all.")

86. *Volatility Definition*, INVESTORWORDS.COM, <http://www.investorwords.com/5256/volatility.html> (last visited May 18, 2008).

87. BLOCK, *supra* note 20, at 14.

statistically by calculating the standard deviation of the return rate.⁸⁸ Because the standard deviation of a stock's price is representative of its volatility, the higher the standard deviation, the greater the volatility and subsequently, the greater the risk. A standard deviation of zero represents an investment with a return rate that never fluctuates.⁸⁹ Put differently, the standard deviation expresses how much the price or value of an investment deviates from its average annual return.⁹⁰

Over the last thirty-three years, REITs have experienced less volatility than other asset classes. Between 1972 and 2005, REITs had a standard deviation of 16.7%.⁹¹ Both the S&P 500 and small stocks proved more volatile during that period. The S&P 500 had a standard deviation of 17.5%, while small stocks proved to be extremely volatile with a standard deviation of 22.8%.⁹²

By maintaining relatively low volatility, REITs lend investors a sense of stability. Although still risky, maintaining this aura of predictability serves well to benefit the industry. With fairly consistent fluctuations, REIT stockholders are less likely to sell their shares, instead holding out for long-term growth. Conversely, high volatility would damage the market by enticing highly emotional investors to sell stock during sharp declines in price.⁹³

By attracting REIT investors, the Asian governments will be able to sustain a larger market capitalization for longer periods and build towards an economic environment that is characterized by stability. If investors are not eager to quickly sell their REIT shares, the total market capitalization of the industry in Asia will increase. Such an increase will, in turn, encourage economic stability and growth.

3. REITs Have Consistently Rewarded Investors with High Returns

Perhaps the most significant attribute of REITs is their ability to consistently outperform virtually all other asset classes. REITs have performed so extraordinarily that they have been dubbed the "high-

88. *Investment Volatility: Standard Deviation*, MONEYCHIMP http://www.moneychimp.com/articles/volatility/standard_deviation.htm (last visited May 18, 2008).

89. *Id.*

90. *Money 101 Lesson 6: Investing in Mutual Funds*, CNNMONEY.COM, <http://money.cnn.com/magazines/moneymag/money101/lesson6/> (last visited Mar. 2, 2007).

91. IBBOTSON ASSOCIATES, *supra* note 69, at 59.

92. *Id.* Compare with U.S. Long Bonds which had a standard deviation of 11.7% and T-Bills which had a standard deviation of 3.0%. *Id.* Long Bonds and T-Bills, however, inherently produce much lower returns. MARTIN CAPITAL ADVISORS, LLP, LONG TERM PERFORMANCE OF STOCKS, BONDS, T-BILLS AND INFLATION 1926-2006, at 11-12, available at <http://www.martincapital.com/main/longterm.pdf> (last visited Apr. 17, 2008).

93. See BLOCK, *supra* note 20, at 14.

growth darling of the new century."⁹⁴ Not only have REITs produced double digit annual returns six out of the last ten years, they have absolutely dominated all other U.S. equity market benchmarks for the last seven years.⁹⁵

Longevity has also been a strong suit for REITs. Over the last thirty years the REIT index has outperformed all other major asset classes. Specifically, REITs have produced a compounded annual return of 13.40%⁹⁶ outperforming the S&P 500,⁹⁷ the Dow Jones Industrial,⁹⁸ and the Nasdaq.⁹⁹ REITs also out performed these assets classes over the last three-year, five-year, ten-year, and fifteen-year intervals.¹⁰⁰ Such longevity is a testament to the endurance and viability of the U.S. REIT market. For years, investors overlooked REITs as a formidable investment vehicle, opting for other well known asset classes.¹⁰¹ Today, the outlook is different; REITs are an accepted asset class, and investors now rely on their performance for the overall success of their portfolios.¹⁰²

This portrayal of REITs undoubtedly helps to attract investment. Specifically in Asia, where returns are above average, it appears as though the Asian governments can rely on the continued success of this asset class. Whereas other industries have not been as consistent with their returns, REITs have certainly established themselves as viable investment vehicles.

94. Carol Llyod, *REITs R Us?*, SFGATE, Dec. 1, 2006, <http://www.sfgate.com/cgi-bin/article.cgi?f=/g/a/2006/12/01/carollloyd.DTL>.

95. NAREIT, *supra* note 82, at 2 (From 2000 through 2006, the REIT index earned annual returns of 25.89%, 15.50%, 5.22%, 38.47%, 30.41%, 8.29%, and 34.35%, respectively. During that same time period, for example, the S&P 500 showed returns of -9.11%, -11.88%, -22.10%, 28.70%, 10.87%, 4.91%, and 15.79%); *see also* IBBOTSON ASSOCIATES, *supra* note 69, at 37.

96. NAREIT, *supra* note 82, at 2.

97. *Id.* (12.47%).

98. *Id.* (8.76%).

99. *Id.* (11.28%).

100. *Id.*

101. Even though they were created in the 1960's, "the industry began to grow as a mainstream investment option only over the past 15 years." Michael Fickes, *\$1 Trillion Milestone*, REAL EST. PORTFOLIO, May/June 2006, <http://www.nareit.com/portfoliomag/06mayjun/feat1.shtml> (quoting NAREIT President and CEO Steven A. Wechsler).

102. "Investors of all types are realizing the benefits of portfolio diversification, strong and reliable income generation, long-term performance, liquidity and transparency that REITs and other listed real estate provide." Poonkulali Thangavelu, *REIT Returns Total 34.5%*, NAT'L MORTGAGE NEWS, Jan. 8, 2007, at 3. "[R]eal estate has gained increased acceptance as a distinct asset class that deserves a permanent strategic allocation in a multi-asset class portfolio." Bigman & Chui, *supra* note 13, at 15.

V. ASIAN GOVERNMENTS MUST COLLABORATE TO DRAFT CONSISTENT REIT LAWS

While it is now clear REITs are a formidable investment option, worthy of legislative amendment, another critical issue within the industry must be examined. Specifically, the legislation existing across the various regimes remains inconsistent, making it an arduous task to attract cross-border REITs.¹⁰³ Cross-border REITs are discouraged from listing in numerous countries because appropriately complying with the regulations of multiple nations can prove costly, time-consuming, impractical, and sometimes impossible. Since these policies serve to effectively limit the number of cross-border REITs, it is imperative for the legal framework of these nations to be modified to a more consistent and liberalized structure.

Because legislation in Singapore, Japan, and South Korea already allows REITs to own and manage foreign assets,¹⁰⁴ these regimes can list on multiple stock exchanges, referred to in this article as *cross-borderization*, providing the main catalyst behind REIT growth in Asia. In other words, if regulations in various countries are able to harmonize and become REIT friendly, REITs will be encouraged to list on multiple exchanges—thereby increasing their market capitalization. A crucial impetus for amending Asian REIT laws is to ease the REIT formation and listing process so as to encourage REITs to pursue listings on multiple stock exchanges.

The ability to list on multiple exchanges provides REITs with access to more investors and stockholders, additional capital, and ultimately a significantly increased market capitalization. As capital increases, REITs can acquire additional assets and subsequently offer more shares. Increasing market capitalization will invite more REITs to the region, help the market stabilize, and consequently benefit the surrounding economies. For these reasons, it is imperative that Asian governments work together and adopt similar REIT regulations.

A. Is Government Collaboration Beneficial for Asian Countries?

Although it would certainly help the growth of the REIT industry, regional collaboration is also beneficial to Asian governments from a socio-economic standpoint. In the wake of the Asian Financial Crisis, many governments in the region are looking for ways to achieve

103. See *supra* notes 46, 50-51 and accompanying text.

104. See EPRA, *supra* note 29, at 34; see also Reilly, *supra* note 16.

financial stability.¹⁰⁵ There is great desire “in most Asian governments to cooperate more closely in terms of financial and institutional assistance to each other.”¹⁰⁶ The circumstances in Asia, however, go beyond desire; regional cooperation is necessary in order to establish financial stability and increase economic growth.¹⁰⁷ The Financial Crisis caused many investors to lose confidence in the region, and for that reason, creating stability within the Asian market is imperative.¹⁰⁸

One way to create stability is to establish regional cooperation among governments. Commentators believe that a proper sequencing of financial reform is needed in order to “achieve long-run currency stability in Asia.”¹⁰⁹ The financial crisis taught regional leaders that East Asia must strengthen monetary and financial cooperation in order to maintain regional financial stability.¹¹⁰ In fact, change has already begun in the region with the introduction of the Chiang Mai Initiative,¹¹¹ Asia’s

105. Mamiko Yokoi-Arai, *Legal and Political Effects of Financial and Monetary Regional Integration in Asia*, 12 L. & BUS. REV. AM. 47, 57 (2006).

106. *Id.* at 57-58 (referencing Pradumna B. Rana, *Monetary and Financial Cooperation in East Asia: The Chang Mai Initiative and Beyond*, (ADB, ERD Working Paper Series No. 6, 2002), available at http://www.adb.org/Documents/ERD/Working_Papers/wp006.pdf).

107. Pushpender Singh Raghav, *China’s Role in Asia and the World Economy: Fostering Stability and Growth*, FIN. INDIA, Jun. 1, 2006, at 330, available at 2006 WLNR 16099162. See also ASIAN DEV. BANK, CENTRAL ASIA REGIONAL ECONOMIC COOPERATION PROGRAM BUILDING PARTNERSHIPS FOR DEVELOPMENT 7 (2004), available at <http://www.adb.org/Documents/CSPs/CAREC/2005/CSP-CAREC-2005.pdf> (“Successful regional cooperation is a crucial element in the future peace and prosperity of Central Asia. Sharing their rich human and natural resources and establishing efficient transport links within the region and beyond are the keys to achieving sustainable economic growth and to improving living standards.”).

108. “[Asian] investors who before 1997 had eagerly flocked to Asian markets suddenly pulled out. Central banks in the region abandoned their pegs and exchange rates depreciated. Like Thailand, banks and firms in these countries were exposed to currency and maturity risks. Thus the initial depreciations weakened balance sheets. Deteriorating balance sheets shook investor confidence and made foreign lenders unwilling to roll over loans. Such sudden massive reversals of capital flows produced twin crises. Banks had to curtail lending, depressing domestic absorption and output. In this environment investor confidence evaporated.” MASARU YOSHITOMI & ADBI STAFF, POST CRISIS DEVELOPMENT PARADIGMS IN ASIA 6 (2003), available at http://www.adbi.org/files/2003.03.books.post_crisis.devt.paradigm.pdf.

109. Raghav, *supra* note 107.

110. Masahiro Kawai, Special Advisor, President of the Asian Dev. Bank, Asian Economies Speaker Series, Asia-Pac. Foundation of Can.: Asian Economic Integration: Progress, Challenges and Opportunities 3 (Oct. 13, 2005), http://www.asiapacificresearch.ca/caprn/dss_project/speech/kawai.pdf.

111. “The Chiang Mai Initiative was designed to expand the existing ASEAN Swap Arrangement (ASA), by extending its coverage to all members of ASEAN and by

attempt at implementing a form of regional integration similar to that of the European Union and NAFTA.

Asian countries are ultimately expected to “step by step, unify their foreign exchange systems, bond markets, stock markets, and finally their currencies.”¹¹² Regional cooperation, therefore, clearly plays an important role in ensuring Asia’s financial stability. Not only does financial cooperation benefit Asia because of its macroeconomic influence, stability within that region is advantageous to the growth of the global economy as well.¹¹³ It remains in the interest of Asian governments to coordinate their REIT laws as well. Individually, the nations do not offer much stability, particularly with a fledgling investment vehicle, but together, the region can attract more foreign investors and achieve greater stability.

VI. WHY MUST THE NUMBER OF CROSS-BORDER REITS INCREASE?

As noted earlier, one reason for amending Asian REIT provisions is to ease the formation process, in turn welcoming the presence of cross-border REITs. Modifying current laws to encourage the prevalence of such ventures will subsequently increase the number of nations¹¹⁴ that a REIT can be listed in. Cross-borderization offers REITs the opportunity to gain market share through increased capital, asset acquisitions, and ultimately available shares.¹¹⁵

Ultimately, the key to the proliferation of cross-border REITs lies in the harmonization of various regulatory provisions.¹¹⁶ Commentators

increasing the size of the swap arrangements, and to create a network of bilateral swap agreements (BSAs) between the countries of ASEAN+3 [(ASEAN plus China, Japan, and the Republic of Korea)].” Seok Dong-Wang & Lene Anderson, *The East Asian Financial Crisis and Regional Cooperation*, BULL. ON ASIAN-PAC. PERSP., 2002/03, at 90, <http://www.unescap.org/pdd/publications/bulletin2002/ch8.pdf>.

112. Raghav, *supra* note 107.

113. “Since regional financial stability is a basis for global financial stability, effective regional financial cooperation is an obvious benefit not only for the regional economies but also for the global community. In this sense Asian regional financial cooperation contributes to the stability of global finance.” Kawai, *supra* note 110, at 3.

114. And in turn, stock exchanges.

115. In one type of growth strategy, a REIT initially owns “properties in just one country before expanding ‘cross border’ into another country, growing bigger upwards in the pyramid and finally becoming largest through REIT mergers and acquisition right at the top.” *Putting REITs on Track*, NEW STRAITS TIMES (Kuala Lumpur, Malay.), Apr. 3, 2006, available at 2006 WLNR 5543771.

116. See Yue, *supra* note 42, at 14 (“It is expected that REIT regulators in Asia offer more attractive tax incentives, encouraging the legislations to attract cross-border REIT activities and promoting local REIT listings.”); CBRE RESEARCH, REITS AROUND ASIA 2 (2006), http://asia.cbre.com.hk/asia/eng/document/marketreports/reits_in_asia_dec06.pdf (“Singapore’s conducive REIT regulatory regime and relatively competitive tax system favourably positioned Singapore to draw an increasing number of cross-

have already begun to recognize cross-borderization as the future of the Global REIT market,¹¹⁷ perhaps even the most decisive factor.¹¹⁸ With the market capitalization of Asian REITs, excluding Australia and Japan, expected to grow to \$25 billion by 2010, cross-border REITs are necessary to reach this level.¹¹⁹ One commentator states: “trends towards sectoral diversification and cross-border listings with overseas assets have become deeply entrenched in the Asian REIT market.”¹²⁰ As these REITs continue to list on multiple exchanges, the overall market capitalization will only continue to grow.

Cross-border REITs also carry significance because they provide for diversification within the REIT entity itself. Since cross-border REITs typically own property in multiple countries, they diversify their portfolio because not all real estate markets move in unison.¹²¹ REITs with a cross-border structure have the ability to look to foreign markets

border REIT listings, further consolidating its status as the regional REIT hub.”); *see also* Press Release, CB Richard Ellis, Asia REIT Capitalization Tops US\$80 Billion, CB Richard Ellis Research Finds, (Sept 19, 2007), http://asia.cbre.com.hk/inet_newsmanager/newsfiles/PR_%20Reits%20Asia_19%20September%202007.pdf (finding the lack of slow-down in Asian REIT growth is due to continuous acquisitions and a long term perspective and that “[l]ooking forward, competition in the Asian REIT market is likely to grow more intense as additional cross-border REITs are listed, particularly in Hong Kong and Singapore”).

117. “With Asian markets adopting REIT legislation, Japan and China continuing as active investor markets, India liberalizing its limitations on foreign ownership of real estate, and European countries like Germany and the UK on the eve of adopting their own REIT laws, cross-border REIT deals will become even more common . . .” 52 REAL EST. WKLY. 21, Jan. 4, 2006, (internal quotation marks omitted), *available at* 2006 WLNR 1279168; *see also The Race is on for China’s First REIT IPO*, INVESTMENT DEALERS’ DIG., Aug. 8, 2005, *available at* 2005 WLNR 15260741 (“[T]he key for China and for any REIT in Asia is the revised rules that allow for cross-border investments.” (internal quotation marks omitted)).

118. “In our view, it appears only a matter of time before high yielding Asian assets are listed in Japan, and high yielding mainland Chinese assets become listed in Hong Kong and Singapore.” HENDERSON GLOBAL INVESTORS, *supra* note 38.

119. *Asia Seen Having More Cross-Border REITs*, BUS. TIMES (Malay.), Sept. 14, 2006, *available at* 2006 WLNR 15930901.

120. CBRE RESEARCH, *supra* note 116.

121. “Cross-border REITs may provide higher yields, lower risk and more opportunities to find value than just restricting oneself to one market.” Grace Ng, *REITs Go Offshore, with Higher Returns . . . and Risks Trusts Setting up Shop Here Now Allow Investor to Tap into Properties in Growing Markets Abroad*, STRAITS TIMES (Sing.), Mar. 5, 2006, *available at* 2006 WLNR 3691532; *see also id.* (“Diversified property funds and cross-border REITs allow investors to potentially reap higher returns by targeting higher-yielding properties in buoyant markets like Japan and Europe.”).

when their local domain is not investor-friendly.¹²² If for instance, the real estate market in Japan suffers a decline, a REIT portfolio may still perform well if the real estate market in Malaysia and Singapore is thriving. Due to the cyclical nature of real estate, the ability to invest in multiple regions and maintain numerous stock exchange listings is a critical incentive for potential investors.¹²³ It is crucial to remember that since purchasing foreign real estate is allowed by virtually all the regimes, listing on multiple stock exchanges is, in fact, the driving force behind cross-borderization.¹²⁴

VII. FLAWED REGULATORY PROVISIONS

As previously explained, the main issue is that Asian REIT regimes maintain stringent and inconsistent regulations making it very difficult for REITs to establish and operate in more than one country.¹²⁵ Hong Kong, for example, has no minimum share capital¹²⁶ requirements, whereas South Korea requires each REIT to have a minimum share capital of KRW 50 million.¹²⁷ Although compliance with the cross-border inconsistencies is not insurmountable, the task can prove to be costly and time consuming. Worse yet, some entities may decide that maintaining a cross-border REIT in Asia is too difficult or not worth the financial commitment.

The regulations explained in the proceeding paragraphs severely hamper the growth of the Asia REIT market, likely causing otherwise interested investors to look elsewhere for efficient investments. These circumstances create the type of unstable investment environment that

122. “Intense competition for properties, has, in some instances, reduced the availability of quality assets, driven up capital values, and led to a reduction in the availability of yield-accretive investments. The dwindling amount of investment opportunities in the domain market may push some REITs to expand boundaries and consider cross-border deals.” Ruby Anne M. Rubio, *Wealth Manager*, BUS. WORLD (Phil.), Oct. 30, 2006, (quoting a Standard & Poor’s Report), available at 2006 WLNR 18781686.

123. Investing in cross-border REITs could pay off because “property cycles vary from country to country, and this allows investors to lower their risks during market downturns.” Ng, *supra* note 121, at 3 (quoting Chris Reilly of Henderson Global Investors).

124. See EPRA, *supra* note 29, at 53-55; see also Reilly, *supra* note 16 (explaining the change in Hong Kong accepting foreign real estate investment).

125. It is important to note that most Asian REITs may purchase assets in foreign nations. This Article deals strictly with the barriers which face REITs that want to be listed and traded on exchanges in various nations.

126. Also known as equity financing, share capital is “[t]he portion of a corporation’s equity obtained from issuing shares in return for cash or other considerations.” *Share Capital*, THEFREEDICTIONARY.COM, <http://financial-dictionary.thefreedictionary.com/share+capital> (last visited Dec. 27, 2007).

127. EPRA, *supra* note 29, at 30-31.

Asian nations have attempted to avoid. If nations can amend their laws and adopt more consistent and liberal policies, a greater number of investors will be attracted to these regimes and growth will increase exponentially, in turn, benefiting the national economies. In other words, deregulation and governmental coordination holds the key to stimulating further growth within the Asian REIT markets.¹²⁸

Consequently, the remainder of this Article focuses on the most crucial discrepancies and draws comparisons to the U.S. regime. Ultimately, policies are offered which seek to benefit the Asian regimes by maximizing market potential.

*A. Leverage*¹²⁹

In general, leverage is the use of borrowed money, taken against the property, to purchase real estate. For instance, a REIT may borrow \$2 million to purchase a \$2.5 million property. So the out of pocket investment for the REIT is \$500,000, but they are gaining appreciation and rental income on a \$2.5 million property rather than a \$500,000 property.¹³⁰ The use of leverage is crucial to the survival of the commercial real estate market because it allows investors to purchase large properties through debt rather than cash.

As REITs grow, they tend to increase their leverage so that their ratio of operations income to capital investment correspondingly increases as well.¹³¹ U.S. law provides a very lenient policy when it comes to leverage considerations and does not impose any limitations on how much debt may be incurred by a REIT.¹³² While unlikely, a REIT may legally use 100% financing to purchase property. As a result, U.S. REITs generally have debt equal to half of their total capitalization.¹³³ In

128. Ooi, *supra* note 40, at 218.

129. For purposes of this Article, the term "leverage" and "debt" will be used interchangeably.

130. Debt service, interest plus principal, is of course paid on the borrowed amount. It is presumed, however, that the interest incurred will still be less than the income earned, the appreciation, or both. The actual property may also be depreciated.

131. *There is No Free Lunch: A Discussion of Leverage in the REIT Sector*, RES. NEWSL. (Green St. Advisors, Inc., Newport Beach, CA), Sept. 16, 1998.

132. EPRA, *supra* note 29, at 49.

133. Jonathan Clements, *REITs: A Better Way to Invest in Rentals*, WALL ST. J. ONLINE, <http://www.realestatejournal.com/secondhomes/20030918-clements.html?refresh=on>.

contrast, other non-financial corporations tend to utilize leverage equating to only one-third of total market capitalization.¹³⁴

The legislative framework is different in Asia, where several regimes have implemented regulations limiting the amount of leverage that a REIT may utilize. Although Japan has followed in the United States' footsteps and allowed for unlimited use of leverage, Hong Kong provisions limit leverage to 45% of net asset value, while laws in Singapore are even more restrictive, requiring a 35% limit.¹³⁵ Recently, legislation in Malaysia raised borrowing limits of REITs to 35%.¹³⁶ The 35% threshold maintained by these nations has caused an outcry among commentators looking to expand growth.¹³⁷ Thailand and South Korea offer extreme examples. In both countries, REITs may not use any leverage.¹³⁸

It remains evident that with respect to leverage restrictions, inconsistencies exist throughout the market. Presumably, lower restrictions are implemented in order to protect investors from unstable REITs that use debt to purchase all of their real estate holdings. Some commentators, however, argue that this is an unnecessary safeguard and that the debt market will ultimately control itself.¹³⁹ Low leverage ceilings ignore that "the credit markets will impose borrowing limitations in respect of individual REIT property holdings in line with the discipline of ordinary commercial practice based on factors which include the

134. Press Release, Green St. Advisors, Inc., Heard on the Beach (May 2, 2005), at 3, <http://www.greenstreetadvisors.com/links/hob050205.pdf>.

135. Michele Lerner, *Investor Appetite Grows for Hong Kong REITs*, REAL EST. PORTFOLIO, July/Aug. 2006, available at <http://www.nareit.com/portfoliomag/06julaug/international.shtml>. In Singapore, however, REITs which are rated by a major agency may use up to 60% leverage. See Richard Mazzochi, *Real Estate Investment Trusts—Positive Regulatory Developments in Hong Kong and Singapore*, MALLESSONS STEPHEN JAQUES, available at <http://www.mallesons.com/publications/2005/Oct/8160052W.htm>.

136. Ooi, *supra* note 40, at 209.

137. "Further liberalisation of the [Malaysian] REIT guidelines is also needed to allow higher gearing limits which is currently limited to 35%—unlike other markets where limits are higher." Sherilyn Foong, *What the Malaysian REITs Market Really Needs*, MALAYSIAN BUS., June 1, 2006, at 8, 9.

138. CHARLES NEO, Q-SERIES®: REITs IN ASIA 22 (2005), available at <http://www.chpacific.com/real/downloads/Oct05AsianREIT-Q.pdf>. "Thailand's REITs are still limited by the restriction on borrowing money and the inclusion of property funds in transactions subject to the 30-per-cent foreign currency reserve requirement . . ." *Asia: Real Estate Investment Trusts to Regain Momentum. Report Says*, THAI PRESS REP., Jan. 15, 2007, (internal quotation marks omitted), available at 2007 WLNR 682571. The use of leverage in South Korea is prohibited unless the funds are borrowed temporarily and are used to rectify cash flow issues. *REITs in Asia*, LINKLATERS, at 3, <http://www.linklaters.com/pdfs/publications/realestate/REITstructuresASIA.pdf> (last visited May 18, 2008).

139. Effie Vasilopoulos, *The Hong Kong REIT Model: Cash Cow or Lame Duck?*, ASIAN FIN. L. BRIEFING, Aug. 2003, at 22, 25, available at <http://www.sidley.com/db30/cgi-bin/pubs/Hong%20Kong%20REIT.pdf>.

quality of the REIT's asset holdings, prospective rental returns and the credit history of the borrower."¹⁴⁰

While the REIT market in Asia is still in its infancy, and protecting investors is crucial to its longevity, maintaining leverage limits below industry averages is an inefficient way to continue growth. Since the average U.S. REIT carries debt at 50% of the net asset value, a 35% leverage threshold likely serves to hinder potential expansion. Extremely stable and reputable REITs that only utilize average amounts of leverage are effectively barred from establishing in Malaysia, Thailand, Hong Kong, and Singapore.

Such circumstances lead to the overall problem of inconsistent laws. A corporation or trust leveraging 50% of its net asset value will be able to establish a REIT in Japan but will be unable to do so in Malaysia, Thailand, Hong Kong or Singapore.¹⁴¹ Limiting formation in this way forces highly leveraged REITs to limit their presence in Asian nations. Such a situation causes the Asian REIT market to fall short of its market capitalization potential, in turn discouraging the flow of investment.

Furthermore, since REIT holdings control hundreds of millions in assets, established REITs will find it virtually impossible to decrease their overall leverage level by 15%.¹⁴² This can prove to be detrimental to growth, forcing many existing REITs to curb their expansion within Asia. This also causes the market to under-perform because REITs that might otherwise list on various stock exchanges will be unable to do so. These circumstances lead to further instability within the market and tend to discourage potential investors.

If markets in South Korea or Thailand want to attract REITs, they must allow for some amount of leverage. In general, it would be in the interest of all countries to increase leverage limitations to at least 50%. By doing so, the governments can protect investors from REITs that utilize very large amounts of debt while simultaneously allowing REITs to employ the standard leverage amounts utilized in the United States.

140. *Id.*

141. This statement presupposes that all other requirements are met.

142. For example, if a Japanese REIT has \$500 million in assets and utilizes the average amount of leverage, 50%, it is borrowing \$250 million. If the REIT were to list in Singapore it would have to decrease its debt by \$75 million to \$175 million. Such a scenario may cause REIT management to rethink listing in Singapore.

B. Formation

Another restrictive aspect of Asian REIT law is the regulations concerning formation. Each nation maintains guidelines on what an organization must do to properly establish a REIT. In most cases, the formation process is long, tedious, and costly. The rigorous provisions are undoubtedly used to protect fraudulent or under-capitalized REITs from harming investors. However, this paternalistic structure, although somewhat useful, significantly hinders growth, particularly the expansion of cross-border REITs.

Some commentators, for example, believe that the listing period in Singapore “is unnecessarily lengthy for a vendor REIT¹⁴³ with a parent company, but when you apply that to a cross-border or third-party REIT, then it becomes a real problem.”¹⁴⁴ The duration of REIT formation in Singapore is short compared to the yearlong process that is required in Japan.¹⁴⁵ Other nations in Asia, outlined below, also maintain regulatory framework that has proven to be extremely restrictive and time consuming.

The United States, however, imposes provisions that are rather conducive to growth. U.S. REITs are not required to endure long investigations or other compliance measures. Instead, the procedure is marked by simplicity, allowing a corporation, trust, or association to form a REIT so long as the entity is taxable as a domestic corporation.¹⁴⁶ All that is needed for REIT election is the preparation of Form 1120-REIT. Generally, U.S. REITs must also be managed by one or more trustees or directors and must have beneficial ownership evidenced by transferable shares or by transferable certificates of beneficial interest.¹⁴⁷

It is apparent, therefore, that the legal structure in the United States is conducive to listing REITs on domestic stock exchanges. Asian REITs, on the other hand, paint a very different picture: one characterized by government oversight and extreme regulatory supervision. The formation procedures in and of themselves restrict growth thereby persuading

143. A vendor REIT is a REIT owned by a parent company.

144. Uma Shankari, *MAS Task Force Considers Shorter IPO Prospectus: Move Expected to Speed Up Listing and Could be a Boon to REITs*, BUS. TIMES (Sing.), Nov. 23, 2006, available at 2006 WLNR 20275449. “Right now, the entire listing process takes from four to six months. For a third-party REIT—that is, a REIT that owns assets bought from third-party vendors, as opposed to a REIT with assets injected from a parent company—a shorter timetable will make a wealth of difference.” *Id.*

145. EPRA, *supra* note 29, at 29.

146. I.R.C. § 856(a)(3), (c)(1) (2008). The code provides for certain exceptions to this statement, however, such exceptions are outside the scope of this Article. *Id.* All that is needed for REIT election is the preparation of Form 1120-REIT. I.R.S. Instructions for Form 1120-REIT (2006).

147. I.R.C. § 856(a)(1)-(2) (2008).

potential REITs not to list in multiple nations because of the time consuming and costly process.

1. *J-REIT Formation*

As already noted, because of stringent securities laws in Japan, it takes approximately one year to establish a Japanese REIT, also known as a "J-REIT."¹⁴⁸ Enabled by the Investment Trust Law, J-REITs are generally formed as corporations as opposed to trusts.¹⁴⁹ The first step in the process is to create an asset management company and then obtain two licenses: a "Building Lots and Building Transactions Agent License" and a "Discretionary Transaction Agent License."¹⁵⁰ Next, the entity must be approved by the Financial Services Agency as an "Asset Management Company."¹⁵¹ After adhering to these provisions, the J-REIT may finally be formed.¹⁵² When compared to the relatively simple process in the United States, a year long registration seems unduly burdensome for a regime that is trying to grow and has not even been around for a decade.

2. *Formation of a Hong Kong REIT*

Similar to Japan, Hong Kong law imposes burdensome requirements on entities wishing to elect REIT status. As a prerequisite, only trusts may form REITs.¹⁵³ The trust must then comply with appropriate securities laws and apply to be listed on the Stock Exchange of Hong Kong.¹⁵⁴ Ultimately, the Securities and Future Commission decides which trusts will be given authority to be listed.¹⁵⁵ The Commission requires, among other characteristics, that the trust invest in real estate that generates rental income, that a significant portion of income is

148. EPRA, *supra* note 29, at 29.

149. ERNST & YOUNG, GLOBAL REIT REPORT 2006 13 (2006), [http://www.ey.com/Global/download.nsf/International/Real_Estate_Global_REIT_Survey_2006/\\$file/EY_REHC_GlobalREITSurvey2006.pdf](http://www.ey.com/Global/download.nsf/International/Real_Estate_Global_REIT_Survey_2006/$file/EY_REHC_GlobalREITSurvey2006.pdf).

150. EPRA, *supra* note 29, at 29.

151. *Id.*

152. *Id.*

153. ERNST & YOUNG, *supra* note 149, at 13.

154. *Id.*

155. EPRA, *supra* note 29, at 27.

distributed in the form of dividends, and that unit holders approve all transactions not at arms length.¹⁵⁶

Once formed, the Hong Kong Code also imposes hefty restrictions on operations and management. For example, to ensure that unit holders' interests are protected, the REIT must appoint a trustee who is "functionally independent" of the REITs' management company.¹⁵⁷ Furthermore, the Commission must also approve the management company hired by the REIT.¹⁵⁸ Lastly, the REIT must hire an independent property appraiser who will conduct appraisals of REIT assets on an annual basis.¹⁵⁹

3. The Result

Ultimately, it is quite evident that the regimes of Hong Kong and Japan are far more restrictive than those in the United States. Government agencies in both nations oversee virtually every stage of REIT formation. This paternalistic structure raises two questions. First, is this overly burdensome regulation necessary, and second, how does it affect the growth of cross-border REITs?

Answering the first question proves trickier than finding a response for the second. After all, some economies in Asia are yet to fully recover from the Asian Financial Crisis of the late 1990s.¹⁶⁰ It may be presumed, therefore, that the extensive "paternal" supervision is a product of the fear instilled by the financial collapse of these nations. Perhaps the governments feel compelled to preempt economic problems. While they are likely protecting their investors, such restrictive guidelines are unnecessary because if too much emphasis is placed on sheltering the countries from financial difficulties, growth will be stalled, and thus further harm the economy.

The formation provisions of Japan and Hong Kong likely hinder REITs formation in foreign jurisdictions. Because each regime requires government approval on various levels, REITs looking to form in these countries will likely have to hire attorneys from these jurisdictions that are familiar with the procedures and language. Attorneys' fees, coupled with processes that can take up to a year to complete, can prove to be a very costly endeavor for many REITs. Even if formation is completed, the jurisdictions require ongoing compliance that would lead

156. *Id.* at 29. The Commission also requires that the trust not actively trade real estate, that the majority of income is derived from rentals, and that a maximum borrowing limit is defined. *Id.*

157. ERNST & YOUNG, *supra* note 149, at 13.

158. *Id.*

159. *Id.*

160. An in-depth analysis of these events is outside the scope of this Article.

to further costs. Though some capital heavy REITs may choose to incur the costs, maintaining such restrictive formation procedures undoubtedly causes REITs to rethink listing within Japan and Hong Kong. REITs may instead look to form in another Asian country. If the regulations were less restrictive, a REIT may choose to form in any number of Asian locations. Such restrictive provisions in the two of the most developed Asian regimes may cause REITs to look to other regions such as America or Europe, where less restrictive formation laws exist.¹⁶¹

Although these Asian REITs are most likely not prepared to take on the liberal formation policies of the United States, amending the present provisions remains imperative for market expansion. Government oversight at multiple levels is unnecessary and extremely time consuming. It may be more efficient to have one large government inspection after a REIT has filed the appropriate paperwork, than periodic requirements throughout the process.

In the fast-paced world of real estate, extensive compliance and government regulation only dissuades potential REITs from formation. Those REITs looking to expand into new areas may choose regions with less restrictive policies so as to ensure that they achieve their goal of formation without incurring high costs. This failure by the Japanese and Hong Kong regimes to capitalize on the success of REITs demonstrates the under-performance that exists within the Asian market, thus prompting a need for regulatory amendment.

C. Share Capital Requirements

Another barrier to cross-border REIT growth is the share capital requirements imposed by most Asian nations. Share capital is “[t]he portion of a corporation’s equity obtained from issuing shares in return for cash or other considerations.”¹⁶² Share capital requirements regulate the minimum amount of money that can be obtained in exchange for shares or units of a REIT. From a potential REIT’s perspective, a nation’s share capital provisions will likely make or break the decision

161. *See supra* notes 146-48 and accompanying text. Similar to the lenient laws of the United States, the BI regime in the Netherlands simply requires that an entity elect for REIT status when it files its annual corporate tax return. Likewise, in France an entity may elect to become a REIT by sending notification to French tax administration before the fourth month of the tax year for which status is sought. EPRA, *supra* note 29, at 9.

162. *Share Capital*, THEFREEDICTIONARY.COM, <http://financial-dictionary.thefreedictionary.com/share+capital> (last visited Dec. 27, 2007).

to enter a particular market. After all, if a REIT does not have enough assets to support an adequate share offering, the share capital requirements will not be met.

Within the Asian REIT markets, there exists a broad spectrum of share capital requirements. Some are quite open while others are very restrictive. The United States does not proscribe a share capital minimum. It only restricts the amount of shareholders and shareholder ownership. The Internal Revenue Code (IRC) requires that an entity which files for REIT status maintain at least one hundred different shareholders and not be closely held.¹⁶³ In addition, under the “5/50” test, five or fewer individuals cannot own more than fifty percent of the value of the REIT’s stock during the last half of its taxable year.¹⁶⁴ Lastly, a REIT may not be owned by certain financial institutions or insurance companies.¹⁶⁵ All of these requirements ensure diversity of ownership so no single individual can attain ultimate control of the REIT.

While the Hong Kong Code contains regulations similar to those of the United States, the regimes of Japan, Malaysia, and South Korea all maintain various restrictions that reduce the amount of nations in which a REIT may list. Laws in Japan require that REITs must either have a minimum investment capital of 100 million yen,¹⁶⁶ be widely held, or ensure share certificates are owned by at least fifty different investors by the close of the fiscal year.¹⁶⁷ The three largest investors must own less than 50% of the shares, and the ten largest investors must own less than 75% of the shares.¹⁶⁸ Lastly, Japanese Code states that at least 51% of the issuing investment certificates must be offered within Japan.

The provisions in Malaysia and South Korea have proven more restrictive than those of Japan. In South Korea for instance, the minimum share capital is KRW 25 billion, approximately \$25.7 million USD.¹⁶⁹ REITs in South Korea must also comply with burdensome laws

163. I.R.C. § 856(a)(5)-(6) (2008).

164. *Forming and Operating a Real Estate Investment Trust*, INVESTINREITS.COM, <http://www.investinreits.com/learn/formingareit.cfm> (last visited May 18, 2008).

165. I.R.C. § 856(a)(4) (2008). The code refers to I.R.C. § 582 to define “financial institution.” The definition includes any bank, any small business investment company operating under the Small Business Investment Act of 1958, and any business development corporation. *Id.* § 582(c)(2).

166. EPRA, *supra* note 29, at 31. As of January, 2008, 100 million yen is approximately \$913,000.00 USD. Yahoo Currency Converter, <http://finance.yahoo.com/currency/convert?amt=1&from=USD&to=JPY&submit=Convert> (last visited Jan 2, 2008).

167. ERNST & YOUNG, *supra* note 149, at 13.

168. *Id.*

169. Clara Lau & Wayne Chu, *Spotlight on Asia: Korea*, REAL EST. PORTFOLIO, Nov./Dec. 2005, <http://www.nareit.com/portfoliomag/05special/p53.shtml>. Yahoo Currency Converter, <http://finance.yahoo.com/currency/convert?amt=25000000000&from=KRW&to=USD&submit=Convert> (last visited Apr. 3, 2008).

regarding shareholder requirements. REIT founders, for instance, must own at least 10%, but no more than 30%, of the outstanding shares.¹⁷⁰ Furthermore, no shareholder, whether an individual or organization, may own more than 30% of a REIT's outstanding shares.¹⁷¹ South Korean law provides that 30% of a REIT's total shares must be offered to the public upon formation.¹⁷²

The Malaysian Code also imposes harsh restrictions on capital requirements and shareholder ownership. Government legislation requires that REITs have a minimum capital fund of MYR 100 million, roughly \$31 million USD.¹⁷³ Furthermore, foreigners are limited to owning only 49% of a given REIT, while *Bumiputera*, an indigenous ethnic group in Malaysia,¹⁷⁴ shareholders must account for at least 30% of the shares.¹⁷⁵

Requiring high share capital requirements likely decreases the *cross-borderization* of REITs. Although the requirements in Japan are negligible, the \$26 million threshold in South Korea and the \$27 million limit in Malaysia have likely slowed the growth of cross-border REITs within those regions. Because of the under capitalization¹⁷⁶ of the Asian market, many REITs likely do not have enough assets to justify a sufficient investor offering and, therefore, have essentially been denied the possibility of listing in Malaysia or South Korea.

With only several years of experience, it is important for these countries to decrease or remove their share capital requirements. In inexperienced countries with low market caps, maintaining high share capital requirements makes it harder for smaller REITs to enter and meet the requirements for listing. Smaller REITs must be encouraged to form within Asia so that the industry as a whole may increase market capitalization. Since the market is still in its infancy, it must cultivate smaller REITs and encourage the introduction of foreign ones as well. Such a change will allow for more properties to come under REIT ownership, thus helping to solve the problem of undercapitalization

170. ERNST & YOUNG, *supra* note 149, at 14.

171. *Id.*

172. *Id.*

173. Clara Lau & Wayne Chu, *Spotlight on Asia: Malaysia*, REAL EST. PORTFOLIO, Nov./Dec. 2005, <http://www.nareit.com/portfoliomag/05/special/p53.shtml>. Yahoo Currency Converter, <http://finance.yahoo.com/currency/convert?amt=100000000&from=MYR&to=USD&submit=Convert> (last visited Apr. 3, 2008).

174. *Bumiputra*, WIKIPEDIA, <http://en.wikipedia.org/wiki/Bumiputra> (describing history of the *Bumiputra*) (last visited Mar. 10, 2006).

175. Foong, *supra* note 137, at 9.

176. *See supra* notes 47-49 and accompanying text.

within the market.¹⁷⁷ Decreasing share capital limitations to \$15 million would allow the governments to restrict under-capitalized firms while still providing small REITs the ability to grow.

Because Japan and Malaysia limit foreign ownership to 49%, many REITs may choose to forgo listing on their exchanges. By limiting foreign ownership, these governments are barring those who have the most to invest.¹⁷⁸ Although unlimited foreign ownership may be an extreme course of action, allowing 60-75% foreign ownership may help attract foreign investors looking to participate in the market's growth.

D. The Crucial Growth Deterrent: Taxation Policy

Although the issues described above hamper the growth of the Asian REIT market, commentators have consistently stated that the chief reason for slow development of REITs in Asia is the lack of preferential tax treatment.¹⁷⁹ The absence of tax transparency¹⁸⁰ is perceived as a major shortcoming in some nations because “[t]ax transparent structures fuel [REIT] growth and where favourable frameworks exist, it is generally seen that unit prices can trade at a premium to the underlying values of a REIT.”¹⁸¹ Favorable taxation guidelines also play a crucial role in attracting foreign investment.¹⁸² As a general rule, there are two issues to consider when analyzing the taxation structure of a REIT regime: how taxation affects the REIT as an entity, and how taxation affects investors, whether domestic or foreign.

1. Taxation Policies in the United States

One reason for the widespread popularity of U.S. REITs is that shareholders are able to avoid double taxation, for the most part.¹⁸³ The fact that U.S. REITs “generally pay no taxes at the corporate level is a factor that will, for a long time to come, motivate many real estate companies to join the trend to REITize.”¹⁸⁴ In the United States, REITs

177. *Id.*

178. *See supra* notes 52-66 and accompanying text.

179. Ooi, *supra* note 40, at 214.

180. “Without tax transparency, the income of REIT stocks would be taxed twice—first, at the corporate level, and then, at the personal level. . . . However, if the REIT enjoys tax transparency status, taxes will only be collected at the personal level.” *Id.*

181. Gurjit Singh, *Putting REITs on Track*, PROP. TIMES (Malay.), Apr. 26, 2006, <http://www.nst.com.my/Weekly/PropertyTimes/News/Focus/20060412091848/Article/> (Property Times is a weekly pullout section of the New Straits Times).

182. Ooi, *supra* note 40, at 214-15.

183. BLOCK, *supra* note 20, at 288 (“REITs rarely pay corporate income taxes; rather, their shareholders pay taxes on the earnings in the form of dividends received.”).

184. *Id.* at 289.

are not liable for corporate tax on the income that they subsequently pay out to their shareholders. Instead, corporate income distributed to the shareholders is taxed as personal income to the shareholders.¹⁸⁵ The IRC, however, provides guidelines on how much income a REIT may retain and how much must be paid as dividends.

At the entity level, the IRC requires REITs to distribute annually 90% of taxable income to shareholders in the form of dividends.¹⁸⁶ The remaining 10% of taxable income is thereafter subject to the appropriate corporate tax rate.¹⁸⁷ The IRC also restricts the sources of income.

The Code prescribes a 75% test and a 95% test. IRC § 856(c)(2) states that at least 95% of a REIT's gross income must come from dividends, interest, rental income, capital gains from securities or real property, tax refunds, and several other limited sources.¹⁸⁸ IRC § 856(c)(3) requires that 75% of a REIT's gross income to be derived from rental income, interest from secured loans, sale of real property, tax refunds, and a limited amount of other transactions outlined in the section.¹⁸⁹ Furthermore, ownership of a subsidiary's securities may not represent more than 20% of a REIT's total assets.¹⁹⁰ Lastly, a REIT must satisfy all requirements at the close of each quarter or risk potential loss of its status.¹⁹¹

From the shareholder perspective, dividend payouts are treated as personal income. Foreign shareholders are subject to a withholding tax that is calculated depending on the source of the income.¹⁹² Dividends from ordinary income are subject to a 30% withholding tax, while dividends from capital gains are subject to a 35% rate.¹⁹³ Dividends that constitute a return of capital¹⁹⁴ face a 10% withholding tax.¹⁹⁵

185. *Frequently Asked Questions About REITs*, INVESTINGINREITS.COM, at 23, available at <http://www.investinreits.com/about/2007FAQ.pdf> ("For REITs, dividend distributions for tax purposes are allocated to ordinary income, capital gains and return of capital, each of which may be taxed at a different rate.")

186. I.R.C. § 857(a)(1).

187. *Id.* § 857(a)(1).

188. *Id.* § 856(c)(2)(A)-(H).

189. *Id.* § 856(c)(3)(A)-(I).

190. *Id.* § 856(c)(4)(B)(ii).

191. *Id.* § 856(c)(4).

192. EPRA, *supra* note 29, at 52.

193. *Id.*

194. "It is not uncommon for REITs to pay out a dividend that exceeds their 'taxable income.' This results in a portion of the dividend being classified as a 'return of capital' under the tax code. . . . Rather than pay income tax on the entire cash dividend, you only pay tax on the ordinary income portion of the dividend and reduce the basis of

2. A Brief Note on Taxation

Tax treatment is an issue for any investment regime for two obvious reasons. First, high taxation of shareholders means less money in investors' pockets and potentially fewer investors overall because of decreased payouts. Second, high taxation at the REIT level results in more money for the government but at the cost of losing potential investors. It is clear, therefore, that when taxation legislation meets investment strategy, a very fine line exists between growth and demise.

It is perhaps unfair to compare the REIT regime of the United States to those of Asia. U.S. REITs have existed for almost fifty years, while the longest tenured regime in Asia is only seven years old. Relatively speaking, the U.S. REIT infrastructure is a beacon of stability, while Asian REITs are, by all accounts, marred by uncertainty. Put differently, the taxation provisions in the United States are a product of the regime's success, not vice versa. The United States can impose stringent withholding taxes on foreign shareholders because they are offering a proven investment vehicle and investors will be interested so long as taxation does not become wholly unreasonable. The circumstances in Asia, however, are markedly different because stability is unproven and long-term growth is yet to be achieved. The governments must create favorable taxation provisions so as to attract potential investors and to attract them away from regimes with more burdensome guidelines. In reviewing the taxation provisions of Asian REITs, it is important to remember that, given their infancy, attracting foreign investors and increasing growth should currently be the main objective.¹⁹⁶

3. The Asian Markets

Because of the epic growth of the Asian markets, commentators have started to analyze how taxation provisions limit continued prosperity in this region. The general belief across REIT markets is that an efficient regime should introduce legislation that eliminates double taxation.¹⁹⁷

your holdings by the return of capital amount." Todd N. Lebor, *Considered REITs? Buffett Has*, FOOL.COM, Jan. 9, 2001, <http://www.fool.com/research/2001/foolstden010109.htm>.

195. EPRA, *supra* note 29, at 52.

196. "Increasingly, we are seeing intensified competition among different countries in Asia for a bigger share of the regional REIT market as well as to attract the interest of overseas investors." Andrew Ness, *Asia REITs Stride Forward*, THE STANDARD (H.K.), Jan. 13, 2006, available at http://www.thestandard.com.hk/news_detail.asp?we_cat=16&art_id=9719&sid=6124987&con_type=1&d_str=20060113.

197. "This means that without tax transparency, the REIT will be subject to income tax and the investors will also be subject to income tax on any distributions from the REITs. Thus, the same source of income will be taxed twice. It therefore makes sense for the tax transparency rules to be adopted since this recognises that REITs exist essentially to

Most Asian nations, however, have been slow to adopt legislation that is favorable to foreign shareholders.

a. Japan

In Japan REITs are subject to corporate income tax.¹⁹⁸ The Japanese Code, however, allows shareholders a deduction for dividends received, thus effectively taxing undistributed income.¹⁹⁹ In order to receive the deduction, REITs are required to distribute 90% of their income to shareholders.²⁰⁰ In addition, domestic and foreign REIT shareholders are subject to a 20% withholding tax.²⁰¹ Any shareholder, however, who owns 5% or less of the outstanding units is only subject to a 10% withholding tax.²⁰²

b. Hong Kong

Hong Kong regulations also provide little transparency²⁰³ at the REIT level. Although Hong Kong REITs do not have to pay property taxes on their assets, they remain subject to corporate-level tax on profits.²⁰⁴ Similar to the United States and Japan, Hong Kong REITs must distribute at least 90% of net income to shareholders in the form of dividends.²⁰⁵ Hong Kong regulations adopt a very liberal stance with all shareholders by not imposing withholding tax on domestic or foreign shareholders.²⁰⁶

pool investors' funds and the income earned by the REITs represent each investors' share of property income. To double-tax such income would render the REITs as inefficient vehicles for the pooling of funds from investors." Jennifer Chang, PRICEWATERHOUSE COOPERS MALAYSIA, *Tax Transparency for Property Trust and Real Estate Investment Trust*, <http://www.pwc.com/extweb/indissue.nsf/DocID/2BBB617E55723F44CA256F0F0017C54B> (last visited Mar. 10, 2007).

198. Graham Turl, *Real Estate Investment Trusts in Asia: Legal Structures Compared*, in DIRECTORY OF ASIAN PROPERTY VEHICLES 2006 26, 29 (2006), available at <http://www.linklaters.com/pdfs/practiceareas/realstate/REInvestmentTrustsinAsia.pdf>.

199. *Id.*

200. *Id.*

201. *Id.* at 30. See also ERNST & YOUNG, *supra* note 149, at 23.

202. Turl, *supra* note 198, at 30; see also ERNST & YOUNG, *supra* note 149, at 23.

203. Tax transparency "refers to a situation where the property trust is not treated as a taxable entity [T]he income . . . is treated as if it is earned by the investors directly." Chang, *supra* note 197.

204. Turl, *supra* note 198, at 29. Taxation of profits rather than property taxation allows for the REIT to make deductions against its profits. *Id.*

205. ERNST & YOUNG, *supra* note 149, at 19.

206. EPRA, *supra* note 29, at 42.

Commentators have found the lack of transparency of Hong Kong REITs extremely detrimental to their growth.²⁰⁷ With no tax benefits at the REIT level it remains “very hard for an owner of real estate to elect to put his real estate in a REIT form and have to comply with all the restriction in a REIT code.”²⁰⁸ Ultimately, investors are discouraged from investing in Hong Kong REITs because the presence of double taxation serves to limit the amount of income that could potentially be distributed to shareholders.²⁰⁹

c. South Korea

Regulations within South Korea require taxation at the REIT level. The Korean code takes a two-tiered approach. Property income is taxed at 14.3% for the first KRW 100 million²¹⁰ and at 27.5% for income above that level.²¹¹ Much like the other structures, Korean REITs must distribute 90% of income in the form of dividends.²¹² Domestic shareholders are subject to a minimum tax rate of 16.5%,²¹³ while foreign shareholders encounter a withholding tax rate of 27.5%.²¹⁴

d. Malaysia

Foreign shareholders in Malaysia also encounter steep taxation provisions. Shareholders outside of Malaysia are taxed at 28%, while distributions to domestic shareholders are taxed as personal income.²¹⁵ At the entity level, REITs are not taxed on income that is distributed to

207. “The major constraint of the Hong Kong market is the lack of tax transparency.” *The Rise of Asian REITs*, GLOBAL PENSIONS, Aug. 2005, available at http://globalpensions.com/feature/feature_pdf_345.pdf.

208. *Id.*

209. “Another feature that has drawn much criticism, and where the Hong Kong REIT may be at a competitive disadvantage, is the lack of tax transparency found in a Hong Kong REIT. Whereas international practice does not tax the REIT directly, but instead allows income earned by the REIT to be taxed in the hands of REIT investors, a Hong Kong REIT is taxed at the REIT level. This tax treatment may discourage an investor from investing in a Hong Kong REIT since a key advantage for many potential REIT investors is avoiding a double layer of taxation . . .” Press Release, Heller Ehrman LLP, *The H.K. REIT: Does it Measure Up?* (Sept. 1, 2003), http://www.hellerehrman.com/en/news/article/article_2771.html.

210. Approximately USD \$100,000. ERNST & YOUNG, *supra* note 149, at 24.

211. EPRA, *supra* note 29, at 38.

212. *Id.* at 36.

213. For income up to KRW 40 million domestic shareholders are taxed at a rate of 16.5%. Income above that level is taxed as personal income to the shareholder. *Id.* at 43.

214. ERNST & YOUNG, *supra* note 149, at 24.

215. Singh, *supra* note 181.

shareholders. All undistributed income is subsequently taxed to the REIT at 28%.²¹⁶

Many analysts have called for Malaysia to reduce taxation of foreign shareholders to attract foreign investment.²¹⁷ Commentators have also identified the overly burdensome taxation of foreign shareholders as a hindrance to growth.²¹⁸ These commentators recognize the need for Malaysia to attract foreign REITs,²¹⁹ thereby decreasing reliance on local investors and REITs. Decreasing the withholding tax would encourage growth, in turn offering investors a wider spectrum of asset classes.²²⁰

4. Possible Tax Suggestions

An investigation into the various tax structures shows the inconsistencies that exist from nation to nation. While Hong Kong provides favorable taxation guidelines for shareholders, REITs are taxed at the entity level. Malaysia and South Korea, on the other hand, maintain favorable taxation measures at the REIT level, but tax foreign shareholders at roughly 28%.

Both methods undoubtedly stymie the introduction of cross-border REITs. REITs established in foreign jurisdictions may find it uneconomical to list their shares in Hong Kong because they would be subject to taxation at the entity level, a liability which does not exist in the other countries. A REIT may forgo formation in Hong Kong, instead

216. ERNST & YOUNG, *supra* note 149, at 19.

217. "To play catch-up with our nearest neighbour Singapore, which is undoubtedly the REIT market leader in this region, Malaysia should firstly need to impose a significant reduction in the foreign withholding tax from the current 28% to 10%, in order to be on par with Singapore, so as to attract the much-coveted foreign portfolio flows." Foong, *supra* note 137, at 9.

218. "A closer examination of existing tax laws on REITs shows that the main deterrent is the taxing of Malaysian REIT dividends based on unitholders' income tax brackets as compared with the foreign investor's tax of 28 per cent. This lack of equality means that net yields will be unattractive to foreign investors, making Malaysian REITs more appealing to local investors." Presenna Nambiar, *Bright Outlook for Malaysian REITs*, BUS. TIMES (Malay.) Jan. 5, 2006, at 08.

219. "The emerging REIT sectors in Asia have made a number of countries restructure local property and tax regulations to make increased cross-border flows easier and encourage investments into and out of the region, driving liquidity and market transparency. . . . Singapore offers withholding tax payable by non-residents at only 10 per cent, 18 per cent lower than what is currently in practice in Malaysia. This limits the development of REITs in Malaysia to within the country, while other REITs are crossing borders and succeeding in their bid to attract more foreign investors." *Id.*

220. Foong, *supra* note 137, at 9.

opting for another jurisdiction. Such a decision ultimately limits the prevalence of cross-border REITs, subsequently slowing market growth.

It remains beneficial for Hong Kong to eliminate entity-level taxation of income that is distributed to shareholders. Taxing income that is distributed as dividends is an outdated approach which holds little credibility in the REIT world. Other nations recognize the importance of tax transparency. By failing to amend its laws, Hong Kong has chosen to reject industry standard, effectively rendering Hong Kong a relatively unfavorable jurisdiction for REIT formation.

With the exception of Hong Kong, all the other regimes that were investigated maintained some form of withholding tax for foreign investors. This type of approach certainly affects the amount of foreign investment coming into these jurisdictions. The higher the withholding tax, the less foreign investors receive on their investment. As noted earlier, the Asian regimes must attract foreign investment in order to continue market growth. Maintaining a foreign shareholder withholding tax of 28% clearly does not create an enticing investment option.

Although completely eliminating a withholding tax may be an extreme option, temporarily decreasing all foreign shareholder withholding taxes to a maximum of 10% would likely increase returns for foreign investors as well as attract more investment. As demand increases, cross-border REITs will enjoy the opportunity to establish themselves in new regions and gain market share within the global investment world. This will benefit the REIT market by both increasing market capitalization and attracting investment, the two most important motivations for Asian countries.

VII. CONCLUSION

This Article leaves little doubt that REITs are a viable investment vehicle. They blossomed in the United States and have now gained acceptance in all parts of the world. The Asian market has shown great potential for investment, and it is only a matter of time before it moves to the forefront of REIT globalization. By working together, Asian countries will be able to establish consistent laws that favor expansion. Encouraging the formation of cross-border REITs will lay the foundation for future stability while simultaneously attracting much needed foreign investment.