

ARE REITS GREEN?

AN ENVIRONMENTAL ANALYSIS OF REAL ESTATE INVESTMENT TRUST LAW IN SINGAPORE

This article is a first attempt at systematically considering the environmental impact of the real estate investment trust ("REIT") legal framework in Singapore. It begins with an overview of the existing regulatory framework for promoting "green" property development and management. While there are mandatory standards that property developers and managers must comply with, these only set the minimum requirements for selected aspects of a development's environmental performance, and aside from some new financial incentives, property developers and managers are merely encouraged to voluntarily strive to go beyond what is legally required. On the other hand, an examination of the legal framework in which REITs operate suggests that it produces strong disincentives towards green property development and management. Recognising that REITs are likely to emerge as a significant property investment vehicle, there may be a need to consider measures to counteract these inadvertent potentially adverse environmental effects.

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I. Introduction

1 In order to achieve desirable environmental objectives, it is often not sufficient to introduce the necessary environmental legal and administrative framework alone. For individuals and organisations to act appropriately towards the achievement of these goals, it is important that

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related laws and policies that are not typically characterised as “environmental” reinforce rather than undermine these objectives.

2 This article is a first attempt at systematically considering the environmental impact of one aspect of the legal regime for property investment, namely the real estate investment trust (“REIT”) legal framework in Singapore. Its aim is modest: to explore the effect of the rules regulating REITs on the behaviour of REIT managers and, in particular, whether these rules are likely to constrain environmentally-friendly real estate investment strategies in respect of the management of REITs.

3 I begin with an introduction on the environmental impacts of buildings, then a quick overview of the existing regulatory framework for promoting environmentally-friendly property development and management. This is followed by an examination of selected aspects of the regulatory and private legal framework in which REITs operate, and an analysis of the likely effect of the framework on the behaviour of REIT managers in terms of pursuing a green agenda. Recognising that REITs are likely to stay regardless of their potential environmental impacts, I conclude with a consideration of some legal measures for mitigating the REIT’s built-in bias against going green.

II. The environmental impacts of real estate development and management

4 The built environment produces a significant impact on the natural environment in the form of land clearance, materials use, energy consumption, pollution, and waste production. In developed countries, the construction and operation of buildings consume a great amount of energy, require a large amount of materials, and generate a considerable amount of construction and demolition waste.¹ Health problems resulting from indoor air pollution have also become one of the most acute environmental problems related to buildings.² Many buildings in

1 *Environmentally Sustainable Buildings: Challenges and Policies* (Organisation for Economic Cooperation and Development, 2003) at pp 20–27, available at <<http://www.oecd.org/dataoecd/19/5/2715115.pdf>> (accessed 20 April 2007). See also David Malin Roodman & Nicholas Lenssen, “A Building Revolution: How Ecology and Health Concerns are Transforming Construction”, *Worldwatch Paper* #124, March 1995, at pp 22–25.

2 *Environmentally Sustainable Buildings*, *supra* n 1, at p 28. See also Roodman & Lenssen, *supra* n 1, at p 25.

cities around the world have “sick building syndrome”, a combination of ailments that are typically associated with time spent in a building, characterised by skin irritations, headaches, and respiratory problems, and thought to be caused by indoor pollutants, micro-organisms, or inadequate ventilation.³

III. Green property development and management

5 As late as the 1990s, the green building movement was still considered “a small fringe activity on the periphery of construction”.⁴ Since then, it has quickly entered the mainstream, and is starting to have a major impact on the development and real estate markets.

6 While there is no definitive view of what constitutes a green building,⁵ most writers agree that green buildings are characterised by an integrated approach to their design and management; they seek to minimise their environmental impact by considering all aspects of the building’s design and post-occupancy management.⁶ A green building is one that applies ecological thinking to the business of creating places for people to live and work.⁷ Ideally, it integrates with local ecosystems, closes the loop on materials systems, maximises the use of passive and renewable energy, optimises its hydrologic cycles and fully implements indoor environmental quality measures.⁸

7 In practice, seven general areas commonly form the foci of green development. These are site selection and building orientation, energy consumption, material selection, indoor environmental quality, water

3 Ted Chen, “One out of Three Buildings ‘Sick’”, *Today*, (10 December 2003).

4 Charles J Kibert, “Green Buildings: An Overview of Progress” (2004) 19 J Land Use & Envtl L 491 at 492.

5 For a description of five competing discourses on green buildings, see Simon Guy, “Alternative Developments: The Social Construction of Green Buildings”, (The Royal Institution of Chartered Surveyors, 1997), available at <http://www.rics.org/NR/rdonlyres/C82C4A1C-2BD8-4E22-9CF4-D570DEC555B/0/alternative_developments_19970901.pdf> (accessed 24 April 2007).

6 Miles Keeping & David E Shiers, *Sustainable Property Development: A Guide to Real Estate and the Environment* (Blackwell Science Ltd, 2004) at p 125.

7 Alex Wilson, *et al*, *Green Development: Integrating Ecology and Real Estate* (John Wiley & Sons, 1998) at pp 6–10.

8 Charles J Kibert & Kevin R Grosskopf, “Radical Sustainable Construction: Envisioning Next-Generation Green Buildings”, White Paper for *Rethinking Sustainable Construction 2006: Next Generation Green Buildings*, 19–22 September 2006, available at <<http://www.cce.ufl.edu/rsc06/PDFs/WhitePaper-RSC06.pdf>> (accessed 24 April 2007).

consumption, construction methodology and life-cycle costing.⁹ The key to green buildings is to seek to minimise environmental impacts in an integrated and holistic way by looking beyond the short-term costs and incorporating life-cycle analyses and resource conservation measures into the site planning, design, construction, operational and demolition stages of the building.¹⁰

IV. The legal framework for the environmental performance of buildings

8 Recognising the potential adverse environmental impacts of real estate development and management, it is not surprising to find aspects of the environmental performance of buildings regulated in Singapore. What is surprising though is that, until recently, so little legal attention has been given to a sector that, in the case of an almost fully urbanised Singapore, clearly has a more than disproportionate impact on the environment. What follows is a summary of the hotchpotch of laws that directly influence the environmental performance of buildings.

9 The siting of buildings is regulated under the Planning Act; any development of land must have the written permission of the competent authority.¹¹ Applications for permission are determined with reference to the country's land use master plan in so far as it is relevant.¹² Administratively, the Pollution Control Department of the National Environment Agency is consulted on the siting requirements and to ensure compatibility with the surrounding land use. Buildings works are subject to the requirements of the Building Control Act¹³ and the Building Control Regulations 2003.¹⁴ The Regulations require, *inter alia*, that residential buildings, other than those built by owners for their own use, be provided with adequate natural lighting and natural ventilation, and are designed and built with energy conservation measures for energy efficiency.¹⁵ The Act also provides, *inter alia*, that before any building works can be carried out, the Commissioner of Building Control must

9 J Leslie Zachariah, Christopher Kennedy & Kim Pressnail, "What Makes a Building Green?" *International Journal of Environmental Technology and Management* 2002; 2(1-3): 38-53 at 42.

10 Keeping & Shiers, *supra* n 6, at p 87.

11 Planning Act (Cap 232, 1998 Rev Ed), s 12.

12 *Id*, s 14.

13 Building Control Act (Cap 29, 1999 Rev Ed), s 12.

14 Building Control Regulations 2003 (S 666/2003).

15 *Ibid*, reg 26.

approve the plans for the works and grant a permit for the works.¹⁶ The Building Control Authority as a matter of administrative practice consults the Pollution Control Department of the National Environment Agency for confirmation that the sewerage, drainage, environmental health and pollution control requirements have been complied with.¹⁷ In addition to checking for compliance with the provisions of the Environmental Pollution Control Act¹⁸ and the relevant subsidiary legislation, the Pollution Control Department also refers to its own non-statutory Code of Practice on Pollution Control for guidance on the use of premises for industrial purposes.¹⁹ Pollution from the actual construction works²⁰ and post-construction occupation of premises are also subject to the provisions of the Environmental Pollution Control Act and its regulations.

10 Resource conservation is also mandated, albeit to a more limited extent. Thus, buildings must be designed and constructed to reduce (a) solar heat gain through the roof and building envelope; (b) air leakage through openings on the building envelope; (c) energy consumption of lighting, air-conditioning, and mechanical ventilation systems; and (d) energy wastage through adequate provisions of switching means.²¹ Wasting water is an offence,²² and water fittings must conform to requirements which stipulate the permitted material and construction.²³

16 Building Control Act, s 5.

17 See <http://www.bca.gov.sg/BuildingPlan/building_plan_submission.html> accessed 24 April 2007); see also National Environment Agency, Code of Practice on Pollution Control (3rd Ed, with amendments in February 2001, June 2002, and February 2004), at p 5, available at <http://www.nea.gov.sg/cms/pcd/coppcc_2002.pdf> (accessed 24 April 2007).

18 Cap 94A, 2002 Rev Ed.

19 *Supra* n 17. Other relevant non-statutory guidelines include the National Environment Agency's Code of Practice for the Control of Legionella Bacteria in Cooling Towers (4th Ed, 2001), available at <http://www.nea.gov.sg/cms/qed/cop_legionella.pdf> (accessed 24 April 2007); and Guidelines for Good Indoor Air Quality in Office Premises (1st Ed, 1996), available at <http://www.nea.gov.sg/cms/qed/indoor_air.pdf> (accessed 24 April 2007).

20 For an examination of how the *Environmental Pollution Control Act* affects the construction industry, see Philip Chan & George Ofori, "Impact of the Environmental Pollution Control Act 1999 on the Singapore Construction Industry", (2000) 5 Asia Pacific Journal of Environmental Law 75.

21 Building Control Regulations 2003, reg 26. These regulations are supplemented by non-statutory-codes as the Code of Practice for Mechanical Ventilation and Air-conditioning in Building (SS CP 13: 1999) and Code of Practice for Energy Efficiency Standard for Building Services and Equipment (SS CP 530: 2006) incorporated into Approved Documents issued under the Regulations.

22 Public Utilities Act (Cap 261, 2002 Rev Ed), s 50(1)(b).

23 Public Utilities (Water Supply) Regulations (Cap 261, Rg 5, 2004 Rev Ed), regs 4 and 8.

Except with the written permission of the Public Utilities Board (“the Board”), no person may use water supplied by the Board to water any garden, lawn or other land by means of a hose or fixed or movable sprinkler.²⁴ Specified water fittings that exceed the capacity or flow rate stipulated by the Board may also not be installed.²⁵ The Board may also require a consumer of water supplied to it to clean, repair, replace or otherwise deal with a water service installation that is causing or is likely to cause wastage, pollution, or contamination of the water supplied by the Board.²⁶

11 Singapore strives to be a “garden city”, so it is not surprising that the enhancement of the greenery surrounding building has not been left out. Planting areas of prescribed dimensions must surround all premises on which building works are to be carried out.²⁷ The Commissioner of Parks and Recreation (“the Commissioner”) must approve these planting areas before building works commence.²⁸ Subsequently, it is the duty of the occupier of the premises to maintain the planting areas according to the specifications of the Commissioner,²⁹ and no person may interfere with the planting areas except with the approval of the Commissioner.³⁰ Trees with a girth exceeding one metre growing on a designated tree conservation area or vacant land may not be felled except with the approval of the Commissioner.³¹ Trees and plants in designated heritage road green buffers may also not be damaged, or be cut without the approval of the Commissioner.³²

12 While command and control laws are good at prescribing what must be done and must not be done, they are not very good at prescribing innovation. For this, some economic incentives exist to encourage the adoption of environmentally-friendly technology. For example, capital expenditure on energy-efficient and energy-saving equipment and highly efficient air or water pollution control equipment is allowed a one-year accelerated depreciation allowance.³³ Singapore-registered companies undertaking innovative environmental projects that

24 *Id.*, reg 39.

25 *Id.*, reg 40.

26 *Id.*, reg 15.

27 Environmental Pollution Control Act, s 23.

28 *Id.*, s 24.

29 *Id.*, s 25.

30 *Id.*, s 26.

31 Parks and Trees Act (Cap 216, 2006 Rev Ed), s 14.

32 *Id.*, s 18.

33 Income Tax Act (Cap 134, 2004 Rev Ed), s 19A(6).

can help to meet the Government's goal of environmental sustainability may, subject to certain eligibility criteria and conditions, be granted financial assistance from the Innovation for Environmental Sustainability Fund administered by the National Environment Agency to cover all or part of the allowable costs of the projects.³⁴ The Agency also administers an Energy Efficiency Improvement Assistance Scheme that helps Singapore registered owners or operators to improve the energy efficiency of their buildings in Singapore by co-funding up to 50% of the qualifying cost of engaging an expert consultant or energy service company to conduct energy appraisals and recommend measures to improve energy efficiency.³⁵

13 Waste generation is discouraged. Industrial waste, which includes waste produced in the course of building and construction, must only be disposed of in a public disposal facility or licensed disposal facility.³⁶ Any refuse taken to a refuse disposal ground or incineration plant maintained by the Director-General of Public Health for disposal or incineration must first be weighed. A fee of between \$77 and \$89 per tonne (depending on time and place) is payable for the disposal or incineration.³⁷ The Director-General may furthermore require any occupier of any work place to recycle or treat any industrial waste found or produced on those premises at his own expense before it is brought to any disposal facility for disposal.³⁸

V. Eco-labelling for buildings

14 Voluntary schemes exist to promote a holistic approach to green property development. Obviously, whether property owners and managers choose to do so will vary according to their personal and organisation's motivations and circumstances.

34 See <http://app.nea.gov.sg/cms/htdocs/category_sub.asp?cid=42> (accessed 24 April 2007).

35 See <<http://app.nea.gov.sg/cms/htdocs/article.asp?pid=2536>> (accessed 24 April 2007).

36 Environmental Public Health Act (Cap 95, 2002 Rev Ed), s 24. "Disposal facility" is defined in s 2 as including "a recycling facility, a refuse disposal ground, any place used for the deposit of refuse or waste, an incinerator or any plant, machinery or apparatus used for the processing or treatment of refuse or waste".

37 Environmental Public Health (Public Cleansing) Regulations (Cap 95, Rg 3, 2000 Rev Ed), reg 24.

38 Environmental Public Health Act, s 28.

15 Eco-labelling is one such voluntary scheme. It operationalises the concept of green buildings by creating a means of holistically measuring a building's greenness. A number of countries have introduced their own certification systems as a means for identifying and measuring the "greenness" of property developments. In addition to global priorities, each country's building rating system necessarily takes into account its own circumstances, including its availability of resources and carrying capacity, and practical economic and social considerations.³⁹

16 To encourage property owners to go beyond the minimum legislated standards, Singapore introduced the Green Mark for Buildings, its own green building rating system, in January 2005 as part of its overall strategy to promote sustainable development in the construction industry, and to demonstrate Singapore's commitment to sustainable development.⁴⁰ New buildings are assessed for their (a) design for energy efficiency; (b) design for water efficiency; (c) site/project development and management; (d) design for good indoor environmental quality and environmental protection; and (e) innovation. Existing buildings are assessed for their (a) energy efficiency; (b) water efficiency; (c) building operations and management; (d) indoor environmental quality and environmental protection; and (e) innovation.⁴¹ In order to be certified, buildings have to score at least 50% of the points in each category other than the innovation category and chalk up a minimum overall total number of points. Depending on the total points awarded, a building may then be awarded a Green Mark Award, Green Mark Gold, Green Mark Gold^{plus} or Green Mark Platinum rating. As of March 2007, 34 awards have been made to buildings in Singapore.⁴²

17 The inadequacy of the Green Mark, being a voluntary scheme, has been highlighted in Parliament. Dr Teo Ho Pin, a mayor and Member of Parliament, argued that:⁴³

39 Joel Ann Todd & Susanne Geissler, "Regional and Cultural Issues in Environmental Performance and Assessment for Buildings" *Building Research and Information* 1999; 27(4-5): 247-256 at 250.

40 Speech by Minister of State for Defence and National Development at the Construction And Property Prospects 2005 Seminar, Singapore, 11 January 2005, available at <http://www.mnd.gov.sg/Newsroom/Speeches/speeches_MOS%202005_110105.htm> (accessed 24 April 2007).

41 See <http://www.bca.gov.sg/GreenMark/green_mark_criteria.html> (accessed 9 June 2007).

42 See <http://www.bca.gov.sg/GreenMark/green_mark_projects.html> (accessed 24 April 2007).

43 *Singapore Parliamentary Debates, Official Report* (1 March 2005) vol 70 at col 941.

In Singapore, the Building Control Authority (BCA) has just launched the Green Mark Building Scheme. This is a voluntary scheme, which audits the extent of environment sustainability elements incorporated in a building. I would urge the Government to do more to spearhead “green buildings” in Singapore. Many buildings in Singapore are not built to achieve efficient operating cost. For example, our lighting systems are not energy-efficient, our air-conditioning systems consume lots of energy, and many buildings do not have facilities for water conservation. These trends, if left unchecked, will further increase the cost of our businesses and erode our business competitiveness. It will also impose more financial burden on building owners and home owners. Many building owners, town councils and management corporations are reluctant or face difficulty to convert their buildings into “green buildings” due to the large initial investment. I would urge the Government to provide incentives to encourage more building owners to improve the environment sustainability of their buildings. These incentives could include increasing plot ratio or allowing change of use without extra development charge, providing double tax deduction for approved green practice expenses, or property tax rebate for “green buildings”.

18 The Government has recently taken steps to address the inadequacy of the Green Mark scheme. It announced that from April this year, all new public buildings, including public housing,⁴⁴ and public buildings more than 5,000m² undergoing retrofitting must have Green Mark certification.⁴⁵

19 Plans are also in the pipeline to amend the Building Control Act to impose minimum requirements on environmental sustainability that are equivalent to the Green Mark certified standards for new buildings and existing ones that undergo major retrofitting.⁴⁶ To encourage private developers to follow the Government’s lead and build more green buildings, and retrofit old ones, a \$20m incentive scheme will offer a grant of up to \$3m per development or \$6 per square metre of built area, to help defray the additional costs of making buildings environmentally friendly.⁴⁷ A \$50m research and development fund has also been set up for the construction and real estate sectors to promote green building technologies, energy efficiency and indoor environment quality over the

44 The policy takes effect for public housing from 1 January 2007.

45 “\$70m Set Aside to Encourage Developers to ‘Go Green’”, *channelnewsasia.com* (14 December 2006).

46 “Govt may Legislate Green Mark Requirements on Buildings”, *channelnewsasia.com* (20 March 2007).

47 See <<http://www.bca.gov.sg/GreenMark/GMIS.html>> (accessed 8 March 2007).

next five years.⁴⁸ The Building Control Authority hopes the schemes will attract 200 to 300 buildings in the next few years, but its long-term target is an addition of hundreds, if not thousands, of Green Mark certified buildings to the current 34. These incentives have been welcomed by developers,⁴⁹ and in the first half of 2007 alone, 27 buildings will be receiving the certification,⁵⁰ but there is still some way to go towards the long-term target.

20 As shown above, until recently, the regulations and economic incentives focus only on selected aspects of pollution control, public health, and local resource conservation. The law has played a limited role in mandating or encouraging property owners to adopt a holistic and integrated approach to improving the environmental performance of their buildings. Voluntary and incentive schemes exist to promote green buildings, but these may be inadequate to overcome the existing barriers to going green. Not only does the law, in my view, not do enough to promote green development and management, but it in fact undermines green development by inadvertently creating additional barriers or disincentives to going green in some instances. One such instance is the law relating to REITs.

VI. An introduction to REITs

21 REITs are essentially property funds. They allow investors to pool their capital for direct and indirect investment in real estate, and at the same time benefit from many of the advantages available to wealthier and more sophisticated investors and businesses that can afford to invest directly in real estate, such as tax advantages and professional management of a diversified portfolio of real estate assets.

22 The first REITs were created in the US in response to Federal REIT legislation enacted in 1960 to enable small investors to pool their wealth in a single tax transparent property vehicle, thereby collectively improving their access to investments in larger income-producing commercial real estate programmes – an opportunity hitherto largely unavailable to the average small investor.⁵¹ The Netherlands and Australia

48 “\$70m Set Aside to Encourage Developers to ‘Go Green’”, *supra* n 45.

49 Jessica Cheam, “New Public Buildings to Go Green from 2007”, *The Straits Times* (15 December 2006).

50 “The Green, Green, Class of Home”, *Today* (21 April 2007).

51 Jack H McCall, “A Primer on Real Estate Trusts: The Legal Basics of REITs” (2001) 2 Transactions: Tennessee Journal of Business Law 1 at 1.

followed suit a decade later. Today, REITs are a significant form of land ownership in the US, Australia and parts of Europe, with hundreds, if not thousands, of REITs listed in their stock exchanges. Since 2000, a number of Asian markets, including Singapore, have started creating similar vehicles for property investment.⁵²

VII. REITs in Singapore

23 The first Singapore REIT, CapitaMall Trust, was listed on the Singapore Exchange (“SGX”) in July 2002, following the issue of regulatory guidelines for property funds by the Monetary Authority of Singapore in 1999.⁵³ Favourable tax treatment not available to companies or unit trusts was given to REITs via an advance ruling within the existing tax framework for trusts. To benefit from similar advance rulings, subsequent REITs have also been structured as listed trusts rather than companies. The runaway success of REITs in Singapore can be seen from the fact that as of 28 February 2007, barely five years after the first REIT listed, there were 15 listed REITs with an aggregate market capitalisation of more than \$25bn.⁵⁴

24 As a form of financial investment, REITs provide an attractive alternative to equity and direct investment in real estate. They require a relatively small outlay in return for a professionally managed diversified portfolio of real estate assets. The yields from REITs are also likely to be higher than those from directly renting out one’s own property. REIT investors also do not incur property transaction costs, such as stamp duties, advertising and real estate agent fees. Units in a listed REIT are also far more liquid assets than the physical property itself and facilitate a quick entrance into and exit out of the property market. REITs distinguish themselves from equities during times of market uncertainty,

52 Other Asian markets include those in Japan, Korea, Hong Kong SAR, and Malaysia.

53 In fact, the REIT was launched much earlier in October 2001 under a different name, but its flotation was aborted due to under-subscription of its units. See Kalpana Rashiwala, “CapitaLand Calls off Singmall Float”, *The Business Times* (13 November 2001). Singmall Property Trust was subsequently renamed CapitaMall Trust and successfully relaunched its initial public offering in May 2002. For a brief historical account leading to the introduction of the REIT regulatory framework in Singapore, see Richard Tan Ming Kirk, *Aspects of Property Law* (Richard Tan Ming Kirk, 2003) at pp 101–103.

54 Monetary Authority of Singapore, Consultation Paper P001-2007: “Enhancements to the Regulatory Regime Governing REITs” (March 2007), available at <http://www.mas.gov.sg/resource/publications/consult_papers/2007/REITS_Consultation_Paper_Review_of_Regulatory_Regime_governing_REITs_23_March_2007.pdf> (accessed 19 April 2007).

with a relatively higher dividend yield and lower debt ratio. Unlike bonds, REITs are also better able to protect against inflation risk, as dividends will track nominal rises in rental rates.

25 Like investors, property owners have welcomed the introduction of REITs in Singapore. Asian businesses have traditionally relied on capital growth rather than rental income to drive their earnings.⁵⁵ While having a flagship piece of real estate had once been considered a source of prestige for many companies, increasingly, the emphasis is on shareholder value and other performance measures such as return on equity. Businesses no longer feel that it makes sense to tie up so much of their capital in low-yielding assets like property. The new wisdom is that exchanging these illiquid assets for more liquid units in REITs or freeing up the capital, and pumping the money back into their core business or returning the excess capital as dividends to their shareholders, improves performance. Typically, these companies do a sale-and-lease-back or enter into very long leases. An additional benefit for such arrangements is the tax relief, as sellers can treat their property rental as expenses instead of holding it in their books as capital.

26 Taking advantage of their popularity, and relatively low cost of capital relative to the yields of their acquisitions, REITs have been aggressively seeking to grow through yield-enhancing acquisitions. The waiver of *ad valorem* stamp duty on the acquisition of properties by REITs for a five-year period starting from 18 February 2005, has significantly also contributed to the lowering of the transaction cost of their acquisitions.

27 It is clear that REITs form a significant class of property owners and managers. Analysts have projected that given the current low penetration rate of REITs in Singapore, there is still room for more acquisitions.⁵⁶ In 2004 and 2005, REIT acquisitions accounted for slightly

55 Liew Mun Leong, "A New Look for the Real Estate Sector", *The Business Times* (9 August 2002).

56 Fiona Chan, "REIT Market Still Has Room to Grow: Property Analysts", *The Straits Times* (25 September 2005). One analysis in November 2005 estimated that about 39% of the investible properties have been acquired by REITs; for offices, 18.4% are owned by REITs; and for industrial property, 21.3% are owned by REITs. See Teh Hooi Ling, "S-Reits Score on Yields and Growth Outlook", *The Business Times* (26 November 2005). Another analysis estimated the penetration for investment grade retail, office, and industrial assets to be at 25%, 13%, and 10% respectively. Feng Zhi Wei, "Asia REITs: Perils and Prospects", *The Business Times* (29 November 2005).

more than half of investment property sales.⁵⁷ By one estimate, REITs are expected to eventually constitute up to 70% of the listed real estate, in line with international trends.⁵⁸ As fewer properties become available for acquisition, REITs are likely to turn their attention to overseas properties⁵⁹ in addition to seeking organic growth through rent increases, tenant remixing, and asset enhancements.⁶⁰

VIII. Selected aspects of the legal and regulatory framework for REITs in Singapore

28 Very little detailed and up-to-date literature on the legal and regulatory framework of REITs exists, so a description of the relevant aspects of the framework at this juncture would be helpful to the environmental analysis that follows.

29 A property fund can be constituted as a company under the Companies Act,⁶¹ a business trust under the Business Trusts Act,⁶² or as a quasi-unit trust regulated as a collective investment scheme under the

57 Kalpana Rashiwala, "Reits Acquisitions Account for Over Half of Investment Deals", *The Straits Times* (1 December 2005).

58 Alexandra Ho, "30% of Listed Properties Could Go Reit Way: UBS", *The Business Times* (28 June 2005).

59 The acquisition of overseas properties has been facilitated by changes to the Code on Collective Investment Schemes ("the Code"), issued by the Monetary Authority of Singapore, to allow less than 100% ownership of properties by REITs, subject to prescribed safeguards to the retention of some control over the management of the properties, changes in dividend distribution policies, and the decision to dispose of the properties, to protect the interest of unit holders. See the Code, Appendix 2 ("Guidelines on Property Funds"), para 6.4, available at <http://www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/Amendments_to_Code_on_CIS_221206.pdf> (accessed 20 April 2007). Foreign-sourced interest and trust distributions received by Singapore-listed REITs are tax exempt under s 13(12) of the Income Tax Act with effect from 17 February 2006. Singapore-listed REITs and their special purpose companies set up to hold overseas non-residential properties are also allowed to recover goods and services tax incurred between 17 February 2006 and 17 February 2010 on the setting up of the special purpose companies and the acquisition and holding of overseas non-residential properties. See Budget Speech 2006, available at <http://www.mof.gov.sg/budget_2006/budget_speech/subsection3.2.html> (accessed 16 July 2006).

60 Grace Ng, "Reits Go Offshore, With Higher Returns ... and Risks", *The Straits Times* (5 March 2006). See also, "CapitaCommercial Eyes 30% of Assets in China, M'sia", *Today* (28 July 2006).

61 Cap 50, 1994 Rev Ed.

62 Cap 31A, 2005 Rev Ed.

Securities and Futures Act.⁶³ Of these, the last mode is currently preferred primarily to enjoy tax benefits. As such, this paper will focus on REITs constituted as a collective investment scheme.

30 Units in a REIT may generally only be offered for purchase or subscription if it is authorised under s 286 of the Securities and Futures Act,⁶⁴ and, generally, if the REIT complies with Division 2 of the Act. A REIT must also comply with a non-statutory⁶⁵ Code on Collective Investment Schemes issued by the Monetary Authority of Singapore under s 321 of the Act (“the Code”), including the Guidelines on Property Funds in Appendix 2 of the Code.⁶⁶

31 The manager of an unlisted or delisted REIT must offer to redeem units in the REIT to the tune of at least 10% of its underlying assets at least once a year.⁶⁷ Such a REIT is unattractive, as it does not offer a high liquidity to investors and is a threat to the cash flow of the REIT. The manager and trustee of a listed REIT may be exempted from

63 Securities and Futures Act (Cap 289, 2002 Rev Ed), s 283. For an analysis of the legal nature of REITs in Singapore and how this has been accommodated in the existing legal landscape without legislative interference, see Hans Tjio & Lee Suet Fern, “Developments in Securities Law and Practice” in *Singapore Academy of Law Conference 2006: Developments in Singapore Law between 2001 and 2005* (Singapore Academy of Law, 2006) ch 2.

64 Securities and Futures Act, s 285. Indeed, s 283A of the Act prohibits any person from using the term “real estate investment trust” to describe an arrangement constituted in Singapore the rights or interests of which are the subject of an offer or invitation unless the arrangement is authorised as a collective investment scheme under s 286 of the Act or the Monetary Authority of Singapore has given its consent in writing or the person belongs to a class of persons declared by the Authority by order published in the *Government Gazette* as a person who may use such a term. Arrangements constituted outside Singapore may be described as real estate investment trusts only if they are collective investment schemes recognised by the Authority under s 287 of the Act.

65 While a failure to comply with the Code is not an offence, there are considerable disincentives for non-compliance. Para 1 of the Code provides that the Monetary Authority of Singapore may take any non-compliance into account in determining whether to revoke or suspend the authorisation of the scheme under s 286 of the Securities and Futures Act and/or the authorisation of new schemes proposed to be offered by the same responsible person. It may also be taken into account in whether to revoke the approval of the trustee or to prohibit the trustee from acting as trustee for any new scheme.

66 *Supra* n 59.

67 Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (S 602/2005), cl 8(2)(a)(iv); and Guidelines on Property Funds, *supra* n 59, para 10.1.

redemption requirements.⁶⁸ In order to be listed, a REIT must satisfy the requirements of the Singapore Exchange Securities Trading Limited Listing Manual (“SGX Listing Manual”), including have a minimum asset value of \$20m and at least 500 unit holders holding at least 25% of its units.⁶⁹

32 A REIT may only invest in real estate; real estate-related assets;⁷⁰ listed and unlisted debt securities and listed shares of non-property corporations; government securities and securities issued by a supra-national agency or a Singapore statutory board; and cash and cash-equivalent items.⁷¹ The permissible investments are subject to quantitative limits. At least 35% of its investments must be in real estate,⁷² and at least 70% its investments must be in real estate or real estate-related assets.⁷³ Not more than five per cent of a REIT’s assets should be invested in a single issuer’s securities or any one manager’s funds.⁷⁴ The MAS is currently consulting the public on its proposal to increase the threshold so that at least 70% of a REIT’s investments must be in *income-producing* real estate, with the remainder in other permissible investments specified in the Guidelines on Property Funds.⁷⁵

33 To limit a REIT’s exposure to the risks and uncertainties associated with property development activities, and also to ensure that a REIT is substantially income producing, a REIT is not to engage or participate in property development activities (other than refurbishment, retrofitting and renovations) whether on its own, in a joint venture with others, or by investing in unlisted property development companies, unless it intends to hold the developed property upon completion.⁷⁶ The total contract value of property development activities undertaken and

68 Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005, cl 8(4). A further incentive to list a REIT is that the Inland Revenue Authority of Singapore has so far only issued advance rulings conferring tax transparency treatment to REITs that are listed or to be listed.

69 SGX Listing Manual, r 404, available at <http://info.sgx.com/SGXRuleb.nsf/VwCPForm_Listing_Manual?Openview&sidenav=issuers> (accessed 24 April 2007).

70 Defined in Guidelines on Property Funds, *supra* n 59, para 1.2(g), as listed or unlisted debt securities and listed shares of or issued by property corporations, mortgage-backed securities, other property funds, and assets incidental to the ownership of real estate.

71 *Id*, para 6.1.

72 *Id*, para 7.1(a).

73 *Id*, para. 7.1(b).

74 *Id*, para 7.1(f).

75 Monetary Authority of Singapore Consultation Paper, *supra* n 54, para 6.2. “Income producing real estate” is not defined.

76 Guidelines on Property Funds, *supra* n 59, para 7.1(c).

investments in uncompleted property developments should not exceed 10% of the REIT's assets.⁷⁷ A REIT is also not to invest in vacant land and mortgages (except for mortgage-backed securities). This prohibition, however, does not prevent a REIT from buying real estate to be built on vacant land that has been approved for development.⁷⁸

34 To protect unit holders from excessive risks from debt and high debt-servicing costs, a REIT is generally not to borrow more than 35% of the value of the underlying assets of the trust. It may borrow up to 60% if its credit rating is obtained from one of the specified rating agencies and the rating is disclosed to the public.⁷⁹

35 To increase transparency and accountability, the Guidelines on Property Funds require a full valuation of *each* of the REIT's real estate assets at least once yearly, in accordance with any code of practice for such valuations.⁸⁰ Further, where its manager proposes to issue new units for subscription or to redeem existing units, a desktop valuation of *all* the real estate assets should be conducted by a valuer unless the assets had been valued not more than six months ago.⁸¹

36 An annual report must be prepared by the manager at the end of each financial year disclosing details of all real estate transactions made in the year, all the REIT's real estate assets, all the REIT's borrowings, the total operating expenses of the REIT, the performance of the REIT in a consistent format, and the net asset value of each unit at the beginning and end of the financial year.⁸² Once listed, a REIT whose market capitalisation exceeds \$75m must, like listed companies, in addition to its full-year financial reporting, also announce its financial statements for each of the first three quarters of its financial year.⁸³

77 *Id.*, para 7.1(e).

78 *Id.*, para 7.1(d).

79 *Id.*, para 9.2. The specified agencies are Fitch Inc, Moody's, and Standards and Poor's.

80 *Id.*, para 8.1. The current "code of practice" is the Singapore Institute of Surveyors and Valuers' *Valuation Standards and Guidelines* (2000). In listed property companies, such valuation, when carried out, is on an aggregate basis. See SGX Listing Manual, *supra* n 69, r 1207(10).

81 Guidelines on Property Funds, *supra* n 59, para 8.2.

82 *Id.*, para 11.2.

83 SGX Listing Manual, *supra* n 69, rr 411 and 705(2).

A. *Fiscal incentives*

37 The continued growth in the number and size of REITs would not have been possible without the creation of an attractive legal and regulatory framework by the government, in particular, the “tax efficient” framework. Indeed, one investment bank has identified Singapore as the dominant “REIT hub” in Asia, excluding Japan, and attributed Singapore’s appeal to its “world class regulations”, tax transparency, and high gearing.⁸⁴ The bank noted that “Singapore has the most liberal tax environment in the world and there’s nowhere else in the world where you can invest in a REIT as an individual and not pay tax”.⁸⁵

38 Ordinarily, the income of a trust derived from or accrued in Singapore, or earned outside Singapore and received in Singapore, is chargeable to income tax. The beneficiaries are chargeable to income on any distributions made by the trust, but receive a proportionate tax credit for the tax paid by the trust.⁸⁶

39 In order to promote the growth of REITs, the Inland Revenue Authority of Singapore issued an advance ruling to each of the 13 existing REITs to give effect to the application of s 43(2) of the Income Tax Act.⁸⁷ Subject to meeting certain terms and conditions, a REIT will not be assessed to tax on its distributed taxable income (other than trading gains from the sale of properties). These unit holders will generally pay tax on the distributions at the tax rate applicable to them, unless they are exempted from doing so. One of the conditions for tax transparency is that a REIT must pay out at least 90% of its taxable income (other than trading gains from the sale of properties) as dividends to unit holders. The current practice is to make these distributions on a quarterly or half-yearly basis.

40 To make REITs even more attractive to individual investors, distributions to individuals, regardless of nationality or tax residence status, who hold the units as investment assets rather than trading assets are exempt from tax.⁸⁸ In order to strengthen Singapore as the preferred

84 Joyce Teo, “S’pore Likely to Stay as Key Asian REIT Market”, *The Straits Times* (28 June 2006).

85 “S’pore to Keep REIT Lead”, *Today* (28 June 2006).

86 Income Tax Act, s 46(1)(b).

87 For the legal status of the Inland Revenue Authority of Singapore Advance Ruling System, see the Circular dated 8 June 2005, available at <<http://www.iras.gov.sg/ESVPortal/resources/advancerulingsystemcircularfinal.pdf>> (accessed 24 April 2007).

88 Income Tax Act, s 13(1)(ze)(v).

location in Asia for the listing of REITs,⁸⁹ with effect from 18 February 2005 for a period of five years, the withholding tax rate on distributions from Singapore-listed REITs made to foreign non-individual unit holders would be reduced from 20% to 10%.⁹⁰ Furthermore, the stamp duty on the instruments of transfer of Singapore properties into Singapore-listed REITs would be waived for the same five-year period.⁹¹

B. Trust deed

41 REITs are also regulated by private law. A REIT has a similar structure to a unit trust in that both are constituted by trust deeds, which set out the trust and contractual rights and obligations of unit holders *inter se*, and between each unit holder, and the manager, and the trustee of the REIT.⁹² The deed typically provides that the trust is established to invest in real estate and real estate-related assets. Unit holders typically have no equitable or proprietary interest in the underlying assets of the trust; their only right is limited to requiring due administration of the trust in accordance with the provisions of the trust deed, including by suit against the trustee or the manager. This includes the receipt of income and other distributions, audited accounts and the annual reports, and participation in the termination of the trust by receiving a share of the proceeds derived from the realisation of the trust's assets less any liabilities.

42 The trustee's responsibilities are largely custodial and administrative. These include safeguarding the rights and interests of the unit holders, holding the assets of the trust for the benefit of the unit holders in accordance with the deed, and exercising all the powers of a trustee and powers that are incidental to the ownership of the assets of the trust. In the absence of fraud, gross negligence, wilful default, breach of trust, or breach of the deed, the trustee is typically entitled to be indemnified out of the trust's assets for its acts and omissions in connection with the office of trustee.

89 Budget Speech 2005, para 2.19, available at <http://www.mof.gov.sg/budget_2005/budget_speech/subsection5.3.html> (accessed 24 April 2007).

90 Income Tax Act, s 43(3B).

91 Stamp Duties (Real Estate Investment Trusts) (Remission) Rules 2005 (S 734/2005), r 3.

92 For an analysis of the dual legal character of a unit trust, see Sin Kam Fan, *The Legal Nature of the Unit Trust* (Oxford University Press, 1997) at pp 70–104; and Lee Chiwi, *Legal Aspects of Unit Trusts in Singapore: Essential Resources for Fund Managers and Financial Services Professionals* (Acumen Publishing, 2001) at pp 24–35.

43 The trustee is typically entitled to an annual trustee's fee based on the value of the trust's assets,⁹³ subject to a minimum absolute sum. It may typically be removed, *inter alia*, pursuant to a resolution passed by at least 75% of the total number of votes represented by all the units in issue at a duly convened unit holders' meeting.

44 The manager typically has general powers of management over the trust assets. Its main responsibility is to manage the trust assets and liabilities for the benefit of unit holders. It sets the strategic direction of the trust and gives recommendations to the trustee on the acquisition, divestment or enhancement of the assets of the trust in accordance with its declared investment strategy. Whenever it considers that borrowings are necessary or desirable in order to enable the trust to meet any liabilities or to finance the acquisition of any property or for the redemption of units, the manager may also require the trustee to borrow on behalf of the trust upon such terms and conditions as the manager deems fit. In the absence of fraud, negligence, wilful default or breach of duty under the deed, the deed typically excludes the manager from liability to unit holders for any loss suffered in any way related to the trust and is entitled to be indemnified out of trust assets against the consequences of such error, act or omission. Aside from owing contractual duties, it is generally agreed that the manager also owes fiduciary duties to unit holders, although the precise scope of these duties is far from clear.⁹⁴

45 The manager is typically entitled to an annual base fee based on the value of trust assets;⁹⁵ a periodic performance fee typically based on net investment income;⁹⁶ or less commonly, on the amount by which the total returns of the trust outperforms a benchmark index; an acquisition fee based on the value of the real estate acquired;⁹⁷ and a divestment fee based on the value of the real estate divested by the trust.⁹⁸

46 The trust deed is required to provide for the removal of the manager, *inter alia*, by way of resolution passed by a simple majority of unit holders present and voting at a general meeting.⁹⁹ In reality, this may

93 Typically between 0.02% and 0.3% per annum.

94 Sin, *supra* n 92, at pp 172–173; and Lee, *supra* n 92, at pp 110–111.

95 Typically between 0.1% and 0.5% per annum.

96 Typically between 3.5% and 5.25% per annum.

97 Typically 1.0%.

98 Typically 0.5%.

99 Guidelines on Property Funds, *supra* n 59, para 4.1.

be difficult to muster as the manager is typically wholly owned by the sponsor, *ie*, promoter, of the REIT who also holds a substantial percentage of the units in the REIT and is not excluded from voting on a resolution to remove the manager. It is also possible to contractually entrench the manager. In one case, Allco REIT, the manager is entitled to be paid a fee of \$20m in the event that it is removed by unit holders within five years from the listing date of the REIT.¹⁰⁰

47 Pursuant to one or more management agreements between the trustee, the manager, and one or more property managers, the property manager, typically a subsidiary of the sponsor or manager, operates, maintains, manages, and markets one or more properties of the trust, and is typically paid a periodic management fee based on a percentage of the gross or net income of each property.¹⁰¹ The property manager is also typically entitled to a leasing commission when it secures a new tenant or a tenancy renewal;¹⁰² the commission is typically based partly on the amount of monthly base rent, and partly on the duration of the lease. Some property managers are also paid a project management fee based on construction costs in respect of the development, redevelopment, refurbishment, retrofitting or renovation of the properties of the REIT. The management agreement is typically for between ten and 20 years, inclusive of an extension period after the initial term. During this period, the property manager's services cannot be terminated without cause. On the termination of the appointment of the property manager, it is the manager's responsibility to procure the appointment of a replacement property manager.

100 See for example, the trust deed dated 12 September 2005 constituting Allco REIT, as amended and restated on 23 February 2006 and 20 March 2006, referred to in the Allco REIT Prospectus dated 23 March 2006, at p 110. The Monetary Authority of Singapore is currently consulting the public on a proposal to disallow provisions in the initial public offering that entrench the REIT manager. Such entrenchment arrangements can still be made if they are specifically approved by a majority of unit holders at a general meeting, with the REIT manager and its related parties abstaining; and the circular to unit holders includes an opinion from the REIT trustee that such arrangements are on normal commercial terms and are not prejudicial to the interests of unit holders. See Monetary Authority of Singapore Consultation Paper, *supra* n 54, at para 2.3.

101 Typically between 2% and 3% per annum of gross income.

102 Typically up to one month's gross rent, depending on the tenure of the new tenancy or renewal.

IX. Environmental analysis

48 As noted above, the literature suggests, rather optimistically, that even from a purely commercial perspective, the total benefits of a green development can outweigh its total costs if one takes a holistic long-term view of the project. To the extent that a REIT has access to a large pool of funds, ownership of a sizable portfolio of homogeneous properties to enjoy economies of scale, and professional property managers to manage these properties, it is easier for a REIT to overcome financial and informational barriers to investing in green buildings.

49 Echoing this view, from an energy efficiency perspective, Parker and Chao, researchers at the Institute of Market Transformation based in San Francisco, have suggested that the economic and managerial structures of REITs provide significant incentives for investments in energy efficiency.¹⁰³ They noted that the performance of REITs is typically measured by its funds from operations, *ie*, the company's net income, not including the effects of depreciation and the gains and losses associated with the acquisition and sale of properties. Given the limits of obtaining new capital and the requirement for a high dividend payout, an important growth strategy would naturally include investments in energy savings, primarily in lighting, and heating, ventilation, and air-conditioning, particularly since energy costs are one of the largest operating expenses, estimated at 20% to 40% of total operating expenses of REITs.¹⁰⁴ Furthermore, since REITs are also required to be more transparent and accountable than the "traditional" landowners in disclosing their financial records, including their bottom-line figures, if not their energy cost, any increase in funds from operations not only yields immediate payoffs in unit holder dividends, but future energy savings can also be immediately capitalised in the form of increases in the price of the units. REITs are particularly well placed to benefit from these opportunities because they are better able to achieve economies of scale resulting from owning multiple properties in certain sub-markets and maintaining centralised accounting systems. This allows them to purchase energy-efficient components and equipment and commissioning services at reduced costs. REIT property managers are also typically motivated by incentives in their contracts to pursue least-cost alternatives to improving net operating income. These incentives can

103 Gretchen Parker & Mark Chao, "REITs and Energy Management", *Institute for Market Transformation Paper* (1999), available at <<http://www.imt.org/PDF%20files/REITS%20%20EEM%20MagFINAL.PDF>> (accessed 24 April 2007).

104 *Ibid*, at pp 1–2.

be in the form of compensation packages tied to net operating income or targets for total operation and maintenance costs rather than for specific items.

50 Unfortunately, as the researchers themselves noted, the empirical evidence suggests that property managers give utility costs relatively low priority. This is particularly the case where under the lease agreements between the trustee of the REIT and the tenants of the buildings, expenses related to the operation of the buildings are borne by tenants. In such cases, any energy-efficient retrofits or commissioning is carried out more to maintain tenant satisfaction and to attract new tenants than to reduce operating costs *per se*. Other reasons offered for the low priority given to energy efficiency by REIT property managers were the apparent unfamiliarity with the relevant technology and services; and a perception that the upfront costs of energy saving equipment and services would be prohibitive for REITs.

51 Taking a broader view of green buildings, urban planning and natural resources, Prof Gary Pivo has posited that there is a latent demand for investment opportunities for sustainable real estate investments.¹⁰⁵ Nevertheless, he concedes that there is an apparent lack of interest in green REITs despite the popularity of socially responsible investments in the US, *ie*, investments that focus on the triple bottom line, namely financial profits, social equity, and ecological integrity.¹⁰⁶

52 That is not to say that energy efficiency does not matter to REITs. For example, Fickes was able to name three REITs “leading the charge into the world of sustainable property”.¹⁰⁷ These REITs considered that utility or energy cost accounted for one-third of the operating expenses of a typical office building, and made up a high percentage of costs that REITs could actually control. Tenants with sustainable initiatives also expect sustainable energy initiatives in the buildings they lease.

53 Suggestions that REITs are inherently likely to voluntarily pursue a green agenda may, however, be overstating the case. A Merrill Lynch

¹⁰⁵ *Id.*, p 25.

¹⁰⁶ Gary Pivo, “Is There a Future for Socially Responsible Property Investments?” *Real Estate Issues* 2005; 30(1): 16–26, at 17, available at <<http://www.u.arizona.edu/~gpivo/Is%20there%20a%20future%20for%20SRPI.pdf>> (accessed 24 April 2007).

¹⁰⁷ Michael Fickes, “Growing Green: Environmentally Friendly Building Practices Stash Operating Costs, Increase ROI and Boost Asset Values”, *Real Estate Portfolio* (March/April 2007) 40, at 42, available at <<http://www.nareit.com/portfoliomag/07marapr/feat1.shtml>> (accessed 6 June 2007).

report in Australia found, for example, that while there was an increasing trend towards the requirement for sustainable developments from a social and environmental point of view, and while consumers as the end of buyer of sustainable houses and apartments like the ethos of being “green”, they were not necessarily willing to pay for the additional costs of making houses and apartments sustainable. The report concluded that on the question for the listed property trust sector¹⁰⁸ of whether being green and sustainable adds value, “[t]he answer appears to be that it adds value from a brand and corporate image point of view but that it does not translate into higher end margins and prices for residential developments”.¹⁰⁹

54 Merrill Lynch’s findings are consistent with local studies, which have repeatedly shown that notwithstanding an awareness by industry and the public of the social benefits of green buildings, green buildings are privately unattractive because the private financial cost of adopting a green agenda is perceived to outweigh its private economic benefits, at least in the short term. Industry professionals in these studies have generally indicated that in the absence of an established demand for green buildings or fiscal measures, they are either unable (due to client or budget constraints) or unwilling to voluntarily bear the unnecessary financial costs and risks of pursuing a green agenda.¹¹⁰

108 The listed property trust in Australia is the equivalent of the REIT in Singapore.

109 Paul Snushall, “Green Property: Does it Pay? – Report for the United Nations Sustainability Project”, *Merrill Lynch Comment* (6 December 2005) at p 12, available at <http://www.unepfi.org/fileadmin/documents/materiality2/property_merrill_lynch_2005.pdf> (accessed 24 April 2007).

110 See George Ofori, *et al*, “Impact of ISO 14000 on Construction Enterprises in Singapore” *Construction Management and Economics* 2000; 18: 935–947; Ho Lay Kien & George Ofori, “Minimising Environmental Impacts in Singapore: Role of Architects” *International Journal of Environmental Technology and Management* 2002; 2(1–3): 244–266; Tay Shieh Ling Jaslyn, “Public Perception Towards Green Developments” (Unpublished BSc Dissertation, School of Design and Environment, National University of Singapore, 2005); Yeo Ya Yan Winifred, “Barriers to Sustainable Construction” (Unpublished BSc Dissertation, School of Design and Environment, National University of Singapore, 2004); Gong Hooi Leng, “A Study of Local Property Management Industry Attitude Towards ISO 14000 EMS Implementation” (Unpublished BRE (Property Management) Dissertation, School of Design and Environment, National University of Singapore, 2004); Tham Leng Cheng, “The Approach by Local Construction Industry to Green Development” (Unpublished BSc Dissertation, School of Design and Environment, National University of Singapore, 2003); Tham Shu Fen, “The Potential for Environmental Legislation in Property Management” (Unpublished BSc Dissertation, School of Design and Environment, 2001); and Lim Kok Seng, “Environmental Management Practices and its Relevance to Property Management of Commercial Buildings” (Unpublished BSc Dissertation, School of Building and Estate Management, National University of Singapore, 1996).

55 The local empirical evidence confirms the observation made elsewhere, that the building development industry is, on the whole, risk averse, striving to produce reliable economic returns by using tried and tested approaches and methods.¹¹¹ REITs are, by their nature, even more risk averse than property industry players in general. They are conservative real estate investment vehicles, intended to attract real estate investors primarily focused on predictable short-term payouts rather than more speculative or longer-term returns. It is submitted that far from having an inherently environmentally-friendly legal framework, the potential scope of a REIT's green agenda is in fact restricted by its legal framework.

56 This submission is to some extent validated by a recent empirical study specifically on the attractiveness of energy-efficient buildings to REITs in Singapore. The study found that energy efficiency was a concern, particularly with the larger REITs, but it was not a priority, particularly when energy costs were borne by the tenants. The tenants themselves did not seem concerned about energy conservation, and energy-efficient premises neither attracted tenants nor led to a direct increase in rental. Furthermore, energy costs made up an insignificant portion of total business expenses. Priority was instead accorded to revenue generation through asset enhancement plans that increase net lettable area or improve the façade of the buildings. This was particularly so as REITs were relatively new investment vehicles in Singapore, and were still in a growth phase, and were thus under pressure from investors to deliver top-line growth and visible returns, rather than long-term returns. This was evident to the REIT management from the fact that investors tended to ask "big picture" questions about growth rather than environmental policies or investments in energy efficiency. While it was true that energy efficiency could increase property values as a result of increased discounted cash flows, this did not necessarily increase the REIT's appeal if these discounted cash flows did not lead to a higher dividend yield. Importantly, the study also found that while the REIT structure did not necessarily discourage worthwhile investments in energy efficiency, the

111 Loren Lutzenhiser, *et al*, "Market Structure and Energy Efficiency: the Case for New Commercial Buildings", *California Institute of Energy Efficiency Report* (2001), available at <http://www.ucop.edu/ciee/docs/market_struct.pdf> (accessed 25 June 2006).

requirements to pay a minimum dividend and limits on borrowing affected the scale of such investments.¹¹²

57 REITs are designed to appeal to investors who are looking primarily for a steady cash return that is in many instances tax-free or tax-reduced. What sets a REIT apart from other forms of property ownership is the tax transparency in respect of the REIT's distributed taxable income, and the exemption on taxable income distributed to investors who are individuals and reduced withholding tax rate on taxable income distributed to foreign non-individual investors. The REIT manager's fee structure encourages managers to focus on growing the REIT through yield-accretive acquisitions and increasing income. Managers who perform well under these criteria are typically rewarded with higher performance fees (based on net income) and base fees (based on the value of underlying assets). Those who disappoint are liable to be removed by a simple majority resolution of the unit holders at a unit holders' meeting, although this may in reality be less of a deterrent where the manager's parent company holds a substantial stake in the REIT. Managers would therefore be reluctant to cut dividend payout, even temporarily, unless there are compelling reasons. In the circumstances, there is in fact little to motivate the REIT manager to invest in measures that benefit the public or the occupants of the REIT's properties if these do not increase the REIT's income. As long as tenants who pay the utility charges are not willing to pay a premium for energy efficiency or healthier indoor environments, investing in green refurbishments that do not provide significant quantifiable financial returns is simply not an attractive use of limited funds.¹¹³

58 The emphasis on current income and dividends may be reinforced if the proposal by MAS to require REITs to invest at least 75% of their funds in *income-producing real estate* is adopted. This term could well exclude properties that are not earning rental for a period of time while undergoing major refurbishments, refittings or renovations. If so, it could further restrict the number of properties that a REIT could put

112 Janice Ho, "Exploring the Relationship between REITs and Energy Efficiency Investments: Rationales of REIT Managements" (Unpublished BSc Dissertation, School of Design and Environment, National University of Singapore, 2007).

113 Parker & Chao, *supra* n 103, at p 3. See also Gretchen Parker, Mark Chao & Victoria Gamburg, "Market Opportunities For Energy Service Companies Among Real Estate Investment Trusts", *Institute for Market Transformation Paper* (1999), available at <<http://www.imt.org/PDF%20files/Market%20Opportunities%20for%20ESCOs%20among%20REITS.PDF>> (accessed 24 April 2007).

through a green major overhaul at any one time, perhaps forgoing opportunities to benefit from economies of scale.

59 The REIT's short-term orientation in terms of performance reporting is another barrier towards a life-cycle approach to investing in environmental performance. REIT managers simply do not have the luxury to take a long-term approach towards maximising yield through increasing income when dividends may have to be declared a few times a year out of funds from operations, thereby rendering performance subject to short-term scrutiny. They have to report the REIT's financial performance quarterly, value each property of the trust at least once a year (and possibly twice a year if the REIT seeks to issue new units to raise capital), and report the annual value in the annual report. As valuation is typically based on capitalising the net income, or on discounting cash flow over a ten-year investment period,¹¹⁴ the emphasis on net income or cash flow as the sole basis of value is reinforced at least once a year.

60 There are also funding constraints to pursuing a green agenda. REITs must distribute most of their taxable income to unit holders in order to maintain their tax transparent status. Furthermore, internal funding for capital expenditure reduces, in the short term, the REIT's liquidity without a corresponding reduction in taxable income of which at least 90% has to be paid out as dividends, thereby potentially creating cash flow problems for the REIT. REITs also have a limited capacity to borrow. Aside from the mandatory borrowing limits, borrowings also incur interest charges and reduce income, and hence dividend payout in the short term. On the other hand, any investment funded by the issue of new units subjects the REIT to another round of costly property valuations if one has not been carried out in the last six months,¹¹⁵ subjecting the investment, along with the valuations, if any, to scrutiny by existing and potential yield-oriented unit holders.

114 This practice is consistent with para 3.5 of *Valuation Standards and Guidelines* (Singapore Institute of Surveyors and Valuers, 2000), which deals with the income or investment method of valuation.

115 The Monetary Authority of Singapore is currently consulting the public on its proposal to remove this requirement if the REIT manager confirms that there is no material change in the value of the properties since they were last valued. See Monetary Authority of Singapore Consultation Paper, *supra* n 54, at para 14.2.

61 The legal limit on the amount of its funds a REIT can invest in property development¹¹⁶ coupled with the relatively risky nature of property development also does not help the green cause as it means that a REIT is more likely to seek out existing buildings to acquire rather than opportunities to develop new properties. The OECD's observation in respect of energy-efficient buildings, that it is more difficult to "incite" owners of existing buildings to improve the energy efficiency of their buildings,¹¹⁷ applies equally to the environmental performance of existing buildings. *Inter alia*, the cost of incorporating improvements to completed buildings is likely to be higher than that for similar new buildings. Owners of the existing building also have the option of leaving things as they are whereas the owners of new buildings must make decisions about the building's future performance. And since new building standards mandated by law generally apply to new building works at the building plan approval stage rather than to existing buildings, there is no need to take account of or anticipate more stringent building performance standards in the future.¹¹⁸ The restriction on developing new properties from scratch or through major refurbishment thus significantly reduces the REIT's opportunities to develop green buildings.

62 Given the circumstances, it is not surprising for REITs to give a higher priority to more direct measures for increasing revenue through "asset enhancements" with short payback periods, such as refurbishments to increasing net lettable area, or making yield-accretive acquisitions. The latter is a particularly attractive strategy as currently, stamp duty need not be paid on the instruments of transfer of Singapore properties to REITs. Managers also benefit as they are paid a fee for making acquisitions. A larger portfolio of properties also increases the base fee payable to the managers. When properties subsequently no longer yield attractive incomes, it may be preferable for them to be sold off, rather than be refurbished, whereupon the manager is typically paid a divestment fee.

X. Overcoming barriers and disincentives to green REITs

63 It seems quite likely that left on their own, REITs are not likely to overcome the barriers and disincentives to pursuing a green agenda for

116 For this purpose, "development" excludes refurbishment, retrofitting, and renovations.

117 *Environmentally Sustainable Buildings*, *supra* n 1, at pp 81–82.

118 See for example, s 5(1) of the Building Control Act.

their properties until a sustainability ethic takes root in society in general, and in investors in particular. Non-legal measures which can be taken to make green buildings more attractive to REITs and investors include undertaking more research targeted at quantifying the financial benefits of green buildings, and raising the awareness of the public and real estate professionals of the benefits of owning, occupying, and investing in green buildings. Aside from non-legal measures such as public education, a number of legal measures, including informational tools, economic incentives, and outright regulation, should also be considered.

64 The most direct way of overcoming or mitigating some of the barriers and disincentives to going green created by REIT law is to target the legislation itself by relaxing the legal requirements on the minimum distribution of dividends and the limits on borrowings in respect of retained earnings or borrowings that are invested in refurbishment, retrofitting and renovations activities that lead to a property achieving a green rating. Similarly, the restrictions on development activities can be modified so as to exclude from their application developments that achieve green certification. Finally, care should be taken to ensure the current proposal requiring a REIT to invest at least 75% of its funds in income-producing real estate does not inadvertently become another barrier to carrying out major refurbishments, refittings, and renovations, particularly if these are for the purpose of improving environmental performance.

65 A positive direct measure could be to introduce, in the property fund guidelines, either a mandatory requirement or incentives in the form of preferential treatment for REITs to invest a minimum percentage of their funds in real estate that has received green certification, whether locally or elsewhere. This requirement would put a premium on green buildings and encourage their numbers to grow to meet the increased demand.

66 More generally, the law has a role to play in jump-starting the demand for green buildings and supply of green buildings. Selected building plans for proposed building works could be made subject to mandatory assessment and rating of its environmental performance as part of the approval process under s 6 of the Building Control Act.¹¹⁹

119 There is currently a similar requirement in Arlington County in the State of Virginia, US. See <<http://www.arlingtonva.us/Departments/EnvironmentalServices/epo/EnvironmentalServicesEpoGreenBuildings.aspx>> (accessed 24 April 2007).

Alongside annual valuations of the properties owned by REITs, annual assessments of the environmental performance of the properties owned by REITs can also be mandated. Such information can raise user and investor awareness of the importance of green buildings. It will also help ethical investors make informed decisions about the green value of a REIT, thereby giving the REIT looking to attract the ethical investors' dollar a motivation to upgrade its environmental performance. To offset the cost of subjecting the proposed development to environmental performance rating, economic incentives can be given to REITs that achieve or meet specified environmental performance standards or requirements.

67 Until the benefits of green buildings are better understood and quantified, financial incentives could be offered to property owners for constructing green buildings or upgrading the environmental performance of existing buildings. As mentioned earlier, the Building Control Authority has already announced its Green Mark incentive scheme. Time will tell whether this incentive is sufficiently attractive.

68 Other forms of economic incentives exist. Several states in the US offer green building tax credits.¹²⁰ For example, New York has since 2002 provided green building tax credits, based on a percentage of allowable construction costs, to owners and tenants of eligible buildings and tenant spaces which meet certain specified performance standards for new and renovated buildings.¹²¹ Using existing environmental performance standards, Maryland offers a tax credit for construction of commercial buildings that meet the Leadership in Energy and Environmental Design ("LEED") Silver standard or better.¹²² In Oregon, a tax credit is also given for achieving a LEED certified standard, but it is calculated on the basis of

120 See "LEED Initiatives in Governments and Schools" (US Green Building Council, updated 1 June 2006), available at <https://www.usgbc.org/FileHandling/show_general_file.asp?DocumentID=691> (accessed 24 April 2007).

121 For an overview of the New York tax credit legislation, see <<http://www.dec.state.ny.us/website/ppu/grnbldg/legis.html>> (accessed 24 April 2007). The Green Building Tax Credit Regulations (6 NYCRR Pt 638), which came into force in May 2002, can be found at <<http://www.dec.state.ny.us/website/ppu/grnbldg/gbprop.pdf>> (accessed 24 April 2007).

122 See <<http://www.energy.state.md.us/programs/commercial/greenbuilding/index.html>> (accessed 20 April 2007). The LEED green building rating scheme is a voluntary, consensus-based national standard for developing high-performance, sustainable buildings. It is the US equivalent of the Singapore Green Mark. See <<http://www.usgbc.org/DisplayPage.aspx?CategoryID=19>> (accessed 24 April 2007).

the square footage of the building rather than as a percentage of the increased allowance cost of making the building “green”.¹²³

69 Bearing in mind that REITs and their unit holders generally pay little or no income tax, it is not clear that tax credits will be attractive to REITs, unless perhaps the credits are allowed against other taxes such as property tax or goods and services tax. Allowing tax credits for the occupiers rather than the owners of green buildings, as long as a building continues to meet the applicable environmental performance standards and requirements, may also help to create a demand for green lease agreements, which set out the respective warranties and covenants on the part of both landlord and tenant in respect of sharing the responsibilities for and benefits of improving the environmental performance of the tenanted property.¹²⁴ Greater demand for green leases may also lead to property valuers revising their valuation practices to take environmental performance into account.

70 Increasing the lettable area of green buildings may directly appeal to REITs. One way this is being done elsewhere is to allow the planning authority to consider the provision of LEED certified green building components as justification for bonus density and/or bonus height requests in site plan proposals for all types of development.¹²⁵ The Urban Redevelopment Authority, Singapore’s planning authority, has demonstrated its willingness to use bonus density as an incentive to induce desirable development. Thus, for example, it recently announced that all new developments, redevelopment, and addition and alteration projects within the Central Business District and Marina Centre were eligible to apply for up to an additional two per cent of the permitted gross floor area for the developments to offset the costs of installing external lighting for the purposes of enhancing the city’s image by

123 See <<http://www.oregon.gov/ENERGY/CONS/BUS/tax/sustain.shtml>> (accessed 24 April 2007).

124 For a description of green leases and their benefits, see Tim Power, “Lease Arrangements for Green Commercial Buildings” *Australian Property Law Bulletin* (4 August 2004), available at <http://www.freehills.com.au/publications/publications_2243.asp> (accessed 24 April 2007); and Jason F McLennan & Ron Perkins, “Green Leases and the Speculative Office Market”, *Environmental Design + Construction* (10 May 2001), at <<http://www.edcmag.com/CDA/Archives/ee4a54b329697010VgnVCM100000f932a8c0>> (accessed 24 April 2007).

125 This is already implemented in Arlington County, Virginia, as part of their Green Building Incentive Programme since 2000. See <<http://www.arlingtonva.us/Departments/EnvironmentalServices/epo/EnvironmentalServicesEpoIncentiveProgram.aspx>> (accessed 24 April 2007).

improving the appearance of the city at night.¹²⁶ A similar incentive scheme for capital investment in achieving Green Mark certification would surely also go some way towards enhancing the city's image.

71 To complement the “carrots” for improving the environmental performance of buildings, “sticks” may as a last resort have to be deployed. In Arlington County, Virginia, proponents whose site plan proposals do not receive LEED certification are asked to contribute to the County's Green Building Fund. This fund is used for education and outreach to the development community on green building issues.¹²⁷ Elsewhere, building regulations have been revised to holistically raise the standards of environmental performance of new and existing buildings alike. One way to do so in Singapore could be to gradually convert the Green Mark from a voluntary environmental performance standard to a mandatory benchmark by requiring the attainment of at least the lowest rung of the Green Mark award before the certificate of statutory completion is issued. This approach has already been adopted in the City of Calabasas, California, which added the Green Development Standards¹²⁸ to the Calabasas Municipal Code, requiring, from January 2004, the establishment, construction or replacement of privately-owned and city-owned, non-residential structures over 500 sq ft to achieve the equivalent of a LEED rating prior to issuance of a certificate of occupancy. Structures between 500 and 5,000 sq ft must meet the LEED certified level and structures over 5,000 sq ft must meet the LEED Silver level. More recently, the City of Pasadena, California, followed suit and added the Green Building Practices Ordinance¹²⁹ to the Pasadena Municipal Code, requiring, from April 2006:

- (a) all buildings of 5,000 sq ft or more of new gross floor area built for use by the City of Pasadena or located on city-owned land;

126 “Circular to Professional Institutes: Lighting Incentive Scheme for Developments in the Central Business District (CBD) and Marina Centre”, URA Circular No URA/PB/2006/06-CUDD (24 March 2006), available at <<http://www.ura.gov.sg/circulars/text/dc06-06.pdf>> (accessed 24 April 2007).

127 See <<http://www.arlingtonva.us/Departments/EnvironmentalServices/epo/EnvironmentalServicesEpoGreenBuildings.aspx>> (accessed 24 April 2007).

128 Chapter 17.34, Calabasas Municipal Code, see <http://www.bpcnet.com/codes/calabasas/_DATA/TITLE17/index.html> (accessed 24 April 2007).

129 Chapter 14.90, Pasadena Municipal Code, see <http://ordlink.com/codes/pasadena/_DATA/TITLE14/Chapter_14_90_GREEN_BUILDING_PRACT/index.html> (accessed 24 April 2007).

- (b) non-residential buildings of 25,000 sq ft or more of new gross floor area;
- (c) tenant improvements of 25,000 sq ft or more of new gross floor area and requiring a building permit; and
- (d) mixed-use projects and multi-family residential projects that include a residential building which has four storeys in height or more of new construction,

to achieve at least a LEED certified level prior to being issued a final certificate of occupancy. Singapore's willingness to demonstrate legislative leadership will put it in the company of these pioneers.¹³⁰

XI. Conclusion

72 Kermit the frog (Jim Henson) once sang, "It's not easy bein' green",¹³¹ and REIT managers will no doubt agree with him. The study of "environmental law" should not stop at the examination of laws that directly address environmental issues. Instead, a more holistic legal approach to environmental protection and enhancement should consider the environmental impact of laws that, at first blush, do not seem to have anything to do with the environment. I have demonstrated in this article that, *prima facie*, the overall environmental impact of the legal framework created for REITs in Singapore is likely to be negative as it is an investment vehicle designed to give expression to and reinforce the preferences of myopic investors looking for short-term financial gains at the expense of the sustainable social benefits in the longer term. Within such a framework, REIT managers are likely to take their cue from such investors, and shun opportunities to improve the environmental performance of the properties they manage for the REIT.

73 Real estate is one of the most significant asset classes in Singapore, and it may be that the current legal framework for REITs helps to "unlock" the financial value of land and facilitate the growth of REITs in Singapore, thereby contributing to Singapore's aspirations to be a regional leader in wealth management. However, land is more than an investment asset to be managed for maximum income; it is also our

130 "Govt may legislate Green Mark Requirements on Buildings", *supra* n 46.

131 For a video of the performance of Bein' Green, see <<http://www.youtube.com/watch?v=RIOiwg2iHio>> (accessed 8 March 2007).

abode in which we live, work and play, and investment decisions that enhance or degrade this abode have serious impacts on our lives that go beyond financial returns. Sustainable development requires us to integrate environmental considerations into all our development decisions, including our investment decisions, so it is unsatisfactory when the law encourages investment in real estate that has the potential to cause environmental harm without simultaneously providing for compensating measures to avoid or mitigate the harm. As REITs increase their dominance of the urban environment, the need to avoid or at least mitigate those aspects of REIT law that encourage unsustainable behaviour will correspondingly become more urgent. It is encouraging that Singapore has taken its first steps towards meeting this need.
