REAL ESTATE INVESTMENT TRUSTS IN SINGAPORE

Recent Legal and Regulatory Developments and the Case for Corporatisation

The regulatory regime for real estate investment trusts in Singapore ("S-REITs") continues to be a work-in-progress. The Monetary Authority of Singapore's initial "light-touch" approach has evolved substantially over the past five years, with the regulatory framework for S-REITs increasingly resembling that which applies to public listed companies. Another significant milestone was the enactment of the Business Trusts Act in 2004 (Act 30 of 2004) which introduced an alternative regulatory framework for existing S-REITs or new trusts that invest in real estate. This article seeks to provide a broad overview of the recent developments in the regulation of S-REITs in Singapore and makes a few suggestions for further reform. In particular, the article questions the continued relevance of the trust structure and split manager-trustee duties for S-REITs and advocates that corporatisation of S-REITs would provide better protection for creditors and unit-holders.

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I. Introduction

1 The origins of real estate investment trusts ("REITs") can be traced to the United States. By the mid-20th century, mutual funds had established a successful and important role as a primary channel

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through which small investors in the US could pool their collective resources and invest in publicly-traded securities that they would not otherwise have had access to. REITs were conceived as mutual funds that would facilitate investment by small investors in real estate properties without having to make substantial capital commitments.[1] At around the same time, the US Congress had to address a shortage in available public capital for the real estate industry and was keen to develop new sources of funds for real estate investment.[2] These factors led to the introduction of REITs in the US in 1960 with the relevant amendments to the Internal Revenue Code (the "IRC").[3]

2 Today, many jurisdictions offer the opportunity to invest in REITs. Since Singapore's first real estate investment trust ("S-REIT") was listed on the Singapore Exchange Securities Trading Limited ("SGX-ST") in 2002, the industry experienced robust growth prior to the global financial and economic crisis that struck in the latter half of 2008. While such success may be partly attributed to the tax advantages that are associated with investment in REITs, this article will focus on the legal and regulatory framework in Singapore which has also been supportive of the growth of the S-REIT industry.

3 There have been significant developments in the laws and regulations relating to S-REITs in recent years, reflecting the constant need to balance the twin objectives of industry development and investor protection. This article sets out an overview of recent changes in the legal and regulatory framework governing S-REITs and explores the alternative legal structures for real estate investment funds in Singapore in light of the enactment of the Business Trusts Act (Act 30 of 2004) in October 2004 (now the Business Trusts Act (Cap 31A, 2005 Rev Ed) (the "BT Act")). Where appropriate, comparisons with Australia, Hong Kong, the UK and the US will be mentioned to give a flavour of how similar issues concerning REITs are being dealt with in other leading REITs markets.

II. Background to REITs: The US experience

4 The early US REITs tended to be organised as business trusts in the State of Massachusetts because firstly, only a trust or an unincorporated association could qualify as a REIT under the IRC prior

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1 Chapter by Pamela J Campbell, Jeffrey B Samuels & Mashiho Yuasa on "United States" ("Campbell *et al*") in *Real Estate Investment Trusts: A Global Analysis* (Rachel Booth & Carolyn Boyle eds) (London: Globe Business Publishing, 2006) ("*Real Estate Investment Trusts* (Booth & Boyle eds)") at p 219.

2 Ways & Means Comm HR Rep No 202, 86th Congress, 2d Session (1960), cited in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 219.

3 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 219.

to an amendment made in 1976; and secondly, common law business trust principles were already well-developed in Massachusetts.[4] As US States such as Delaware and Maryland enacted statutory business trust rules, REITs organised as business trusts no longer remained the domain of Massachusetts.

5 In the present day, it is in fact more common for publicly-traded REITs in the US to be organised as state law corporations. According to one source, more than 70% of REITs were constituted as state law corporations.[5] This development mirrors the dominance of corporate structures in the US collective investment sector, particularly in the case of actively managed funds.[6]

6 It would be worth pausing for a moment to take note of some of the key features of REITs in the US in order to appreciate the policy intent behind their existence. First, regulated investment companies in the US are granted an exception to the standard two-tier system of taxation, that is, they get a deduction against the taxable income that they pay as dividends to their shareholders.[7] This exception was extended to REITs at their inception. For a REIT to qualify for this deduction in a taxable year, the general requirement is that it distributes at least 90% of its taxable income to its shareholders.[8] There are other conditions that must be fulfilled, for example, certain items of non-cash income are excluded from the 90% distribution requirement, and distributions should generally be made on a *pro rata* basis among the shares of any one class.[9] There are no stipulations on distributions of net capital gains, except that the undistributed amount of net capital gains will be subject to, *inter alia*, federal income tax.[10]

7 Concomitantly, REITs, like regulated investment companies in the US, have to comply with prescribed regulatory standards. For example, a REIT – like an investment company – must be widely held[11]

4 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at para 2, p 220.
5 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at para 2, p 220.
6 Hans Tjio, "The Regulation of Unit Trusts and Trustees' Powers to Invest in Them" (1999) Sing JLS 148 ("Tjio, 'The Regulation of Unit Trusts'") at 156.
7 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 219.
8 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 226.
9 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 226.
10 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 228.
11 A REIT must be held by 100 or more persons for 335 days of a full taxable year or a proportionate portion of a shorter taxable year. This requirement is waived in the REIT's first taxable year. See Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 222.

because its *raison d'être* is to pool the funds of small investors; it is not meant to serve as a vehicle for large investors to exploit tax advantages.[12]

8 In the US, restrictions on the types of property that comprise the assets of a REIT are implemented through the quarterly asset tests and annual gross income tests that a REIT must satisfy in order to qualify for, and to maintain, the REIT status.[13] Briefly, the assets test comprises the following:[14]

(a) At the end of every quarter, at least 75% of the value of the total assets of the REIT must consist of real estate assets, cash and cash items (including receivables), and government securities (the "75% asset test"); and

(b) The 'securities tests':

(i) At the end of every quarter, not more than 25% of the value of the REIT's total assets may consist of securities, other than those included in the 75% asset test;

(ii) Not more than 5% of the value of the REIT's total assets may consist of securities of any one issuer, excluding the 75% securities and the shares of taxable REIT subsidiaries;

(iii) The REIT may not hold securities that carry more than 10% of the total voting power or the total value of the outstanding securities of any one issuer, subject to the same exclusions as (ii) above; and

(iv) At the end of every quarter, not more than 20% of the REIT's total assets may be constituted by securities or one or more taxable REIT subsidiaries.

As for the income test, the requirements, in summary, are that for each taxable year:[15]

(a) At least 75% of the gross income of a REIT must be derived from real estate sources (the "75% income test"); and

(b) At least 95% of the gross income of a REIT must be derived from real estate-related sources included in the 75% income test as well as other specified sources, including dividends, interest and gain from the sale of stock and securities.

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12 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 222.
13 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 229.
14 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 229–232.
15 Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 235–236.

9 To sum up, it is now more common for US REITs to be organised as corporations rather than (business) trusts. Income tax is not imposed on a US REIT at the entity level, provided at least 90% of the REIT's taxable income is distributed to its shareholders. To qualify for, and to maintain the status of a REIT, US REITs are subject to stringent rules in relation to, *inter alia*, the nature of their investor base and the types of eligible property that they can invest in.

III. Introduction to S-REITs

A. Market size

10 CapitaMall Trust was listed on the main board of the SGX-ST on 17 July 2002,[16] becoming the first S-REIT to be successfully launched in Singapore. Since then, listed property-related investment trusts have become an important and popular asset class in Singapore. Compared with direct property ownership, S-REITs, being publicly-traded investment vehicles, offer the prospect of achieving much better liquidity and broader diversification in real estate investment, with less capital commitment.

11 In the seven years since CapitaMall Trust's debut, another 20 property-related investment trusts have been listed on the SGX-ST. Their total market capitalisation was approximately S$26bn as at 30 October 2009.[17] Prospective investors have a broad spectrum of choice in terms of the types of property that they can select since there are trusts that invest in domestic as well as foreign real estate that cover the retail, commercial, industrial, and residential (including serviced apartments) sectors.

12 The most recent listing of a property-related investment trust in Singapore was that of Indiabulls Properties Investment Trust in June 2008, the only such listing on the SGX-ST in 2008. The lack of new listings since then could reflect heightened caution amongst prospective issuers in response to a generalised weakening of property market conditions at home and abroad.

B. Legal structure

13 Unlike the majority of US REITs but similar to REITs offered in Australia and Hong Kong, S-REITs are predominantly organised as unit

16 SGX website <http://www.sgx.com/wps/portal/marketplace/mp-en/products/securities_products/reits> (accessed 30 October 2009).

17 SGX website <http://www.sgx.com/wps/portal/marketplace/mp-en/products/securities_products/reits> (accessed 30 October 2009).

trusts, a form of collective investment scheme ("CIS") that is based on the common law concept of trust. A decade ago, Prof Tjio observed in the context of unit trusts that:[18]

> [T]he major influences on the unit trust no longer exist, and it has been argued at '[a]t some point, the limitations of trust law must begin to show'.

One of the issues that will be explored in this article is whether Prof Tjio's insights are also relevant for the future development of the S-REIT industry.

14 Since the BT Act came into force in 2004, trusts that invest in real estate may also be constituted as business trusts. Thus there will be some discussion in this article about the different regulatory treatment for S-REITs that are constituted as CIS as opposed to business trusts that invest in real estate, albeit this article deals mainly with the former (and "S-REIT" will be used in that context unless otherwise stated).

15 There are important differences between a REIT (being a CIS that invests in real estate) and a CIS that invests in securities ("securities CIS"), and these differences call for different regulatory approaches. As noted by the Monetary Authority of Singapore (the "MAS"):[19]

> (a) A securities CIS is an open-ended investment vehicle and its manager is obligated to sell or redeem units of the CIS at its net asset value ("NAV"). A REIT, on the other hand, is a closed-end fund, so investors may only "redeem" their units by selling them on the stock exchange, with no guarantee that the REIT is then trading at or near its NAV.
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> (b) The underlying assets of a REIT, being real estate, are less liquid, and their valuation would be more subjective in nature, than the underlying assets of a securities CIS.
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> (c) Most REITs continue to transact with related parties after their formation and listing because REITs are typically sponsored by property holding or development companies.

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18 Tjio, "The Regulation of Unit Trusts" at 156–157; Y L Tan, "Selected Issues in Unit Trusts", *Equity and Restitution in Commercial Practice*, 19 November 1993, Faculty of Law, National University of Singapore Continuing Legal Education Programme (see Tjio, "The Regulation of Unit Trusts" at n 47).

19 The Monetary Authority of Singapore, *Review of the Regulatory Regime Governing REITs* (10 June 2005) ("MAS, *Review of the Regulatory Regime Governing REITs*") at para 4, p II <http://www.mas.gov.sg/resource/publications/consult_papers/2005/REITS_Consultation_Paper_Review_of_Regulatory_Regime_governing_REITs.pdf> (accessed 1 June 2009).

16 The guidelines published by the MAS in relation to property funds, *ie* S-REITs which are constituted as CIS (the "Property Fund Guidelines") are contained in Appendix 2 to the Code of Collective Investment Schemes which was first issued by the MAS in May 2002 and were most recently revised in September 2007 (the "CIS Code"). Although the CIS Code is non-statutory, the MAS may take into account a breach thereof by the responsible person of a CIS in determining whether to revoke or suspend the authorisation or recognition of a CIS under the SFA and/or refuse authorisation or recognition to new schemes that the responsible person proposes to offer. With the introduction of a licensing regime for managers of S-REITs, the MAS is further able to prevent a person who is proven to have violated the CIS Code in his previous dealings from being involved in the management of S-REITs.

17 S-REITs are subject to Part XIII of the Securities and Futures Act (Cap 289, 2006 Rev Ed) (the "SFA") which, *inter alia*, governs offers of investment as well as the authorisation and recognition of CIS. With a recent amendment to the SFA, S-REIT managers are now required to be licensed by the MAS (see discussion below at para 26), while S-REIT trustees are regulated under the Trustees Act (Cap 337, 2005 Rev Ed) except where the governing trust deed of the S-REIT provides otherwise. Certain provisions in the Companies Act (Cap 50, 2006 Rev Ed) (the "Companies Act") as well as general company law principles could also be relevant to S-REIT trustees.

18 While the principal focus of this article is the regulation of S-REITs, the next section will first highlight salient features of the tax treatment of S-REITs since the rules on tax-efficiency are the major contributory factor to the success of REITs in Singapore and elsewhere.

C. Tax treatment

19 In different jurisdictions, different "hurdle rates" apply in terms of the proportion of the property fund's taxable income that has to be distributed to unit-holders in order for the fund to qualify for REIT status and, concomitantly, favourable tax treatment.[20] In Singapore,

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20 REITs are treated as tax transparent in Singapore and the US. In Japan, distributions are deductible from corporate income tax if the REIT distributes 90% of its taxable income. Source: Chapter by Jerry Koh on "Singapore" ("Koh") in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 192–193; Campbell *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 224 and 240; Graham Turl, "Real Estate Trusts in Asia: Legal Structures Compared", IPD Directory of Asian Property Vehicles 2006 (in respect of Japan) <http://www.linklaters.com/pdfs/practiceareas/realestate/REInvestmentTrustsinAsia.pdf> (accessed 13 June 2009) ("Turl, 'Real Estate Trusts in Asia'"). Favourable tax treatment does not necessarily take the form of tax transparency. In Hong Kong, a REIT that holds property

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Hong Kong, Japan, the UK and the US,[21] the requirement is for at least 90% of the taxable income of a REIT to be distributed; in Australia, 100% of a REIT's income must be distributed each year.[22]

20 Although the MAS first laid down the ground rules for the operation of S-REITs in May 1999, it was not until 2001 – when the Inland Revenue Authority of Singapore formulated a policy of granting tax transparency to S-REITs on a case-by-case basis – that S-REITs became an attractive investment option.[23] The listing of CapitaMall Trust's predecessor, SingMall Property Trust, in the fourth quarter of 2001, was withdrawn because, amongst other reasons, SingMall Property Trust had not been granted tax transparency, thereby putting a drag on its offer yield, and conversely, the successful launch of CapitaMall Trust the following year could be partly attributed to its tax transparency status.[24]

21 Since then, the Singapore Government has proactively introduced further changes to the tax regime to enhance the value-proposition of S-REITs:

(a) In the Singapore Budget for Financial Year 2004/2005, the Singapore Government announced that individual unit-holders need not pay income tax at their marginal rates of income tax in respect of distributions from the taxable income of authorised S-REITs earned from 1 January 2004 onwards, regardless of the individual unit-holder's nationality or tax residence status, provided that the units are not held through a partnership.[25]

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through a special purpose vehicle may be subject to profits tax; this is preferable to paying property tax if the REIT held the property directly because certain items such as debt interest payments and management fees may be deducted against profits. See Turl, "Real Estate Trusts in Asia". In the UK, the REITs legislation ring-fences the REIT's property rental business, which is tax-exempt, from any other business it carries out. The REIT does not pay corporation tax in respect of the income profits from its tax exempt business or the gains on assets used wholly and exclusively for the purpose of its tax-exempt business. See chapter by Mark Baldwin & Stephanie Tidball on "United Kingdom" ("Baldwin & Tidball") in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 205–206.

21 Chapter by Teresa Leung & Phillip Smith on "Hong Kong" ("Leung & Smith") in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 104.

22 Chapter by Nathan Deveson *et al* on "Australia" ("Deveson *et al*") in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 17.

23 Tan Ser Ping, "SINGAPORE: Evolution and Future Development of the REIT Market" in *REITs in Asia: From Concept to Completion* (Darrell Wright ed, Manju Manglani managing ed) (Asia Law & Practice, Euromoney Publications (Jersey) Limited, 2005) ("Tan Ser Ping in *REITs in Asia*") at p 109.

24 Tan Ser Ping in *REITs in Asia* at p 111.

25 Koh in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 193.

(b) The following year, with an eye on the competition from Australia, Malaysia and Hong Kong, the Singapore Government announced that most of the qualifying conditions for tax transparency would be removed in order to attract more S-REIT listings. Stamp duty on the instruments of transfer of Singapore properties into S-REITs to be listed, or already listed on the SGX-ST, would be waived for a five-year period; and the withholding tax on REIT distributions would be lowered from 20% to 10%, also for a five-year period, in order to attract investments from foreign non-individual investors.[26]

(c) Additional measures to boost the S-REIT market were announced in the Singapore Budget for Financial Year 2006/2007. These measures aimed to make Singapore the "choice listing location" for S-REITs by lowering or eliminating the taxes paid on foreign-sourced dividends and interest derived from foreign properties.[27] Given Singapore's limited land resources, the foreign investments made by S-REITs and cross-border REITs[28] will be a vital source of future growth of the S-REIT sector.[29]

IV. Regulation of S-REITs

A. May 1999: Publication of the first edition of the Property Fund Guidelines

22 As pointed out in an earlier commentary, it was the investment community, *viz* S-REITs issuers and investment bankers, who desired that S-REITs be regulated by the MAS in order to raise investors' comfort level with this new asset class.[30] This was notwithstanding the

26 Minister for Finance's Budget Statement for FY2005/2006 at para 2.19, p 9 <http://www.mof.gov.sg/budget_2005/budget_speech/downloads/FY2005_Budget_Statement.pdf> (accessed 13 June 2009). Individual investors (whether local or foreign) receive the distributions exempt of Singapore tax.

27 Minister for Finance's Budget Statement for FY 2006/2007 Annex A at p 37 <http://www.mof.gov.sg/budget_2006/budget_speech/downloads/FY2006_Budget_Statement.pdf> (accessed 13 June 2009).

28 With such REITs, however, cross-border taxation would be a major consideration that could be managed through well-designed double taxation agreements. See Tan Ser Ping in *REITs in Asia* at p 116.

29 Koh in *Real Estate Investment Trusts* (Booth & Boyle eds) at pp 201–202. An example of a cross-border S-REIT is Fortune REIT which is invested in 11 retail malls and properties that are all located in Hong Kong. Another example, the Indiabulls Properties Investment Trust, invests in prime commercial properties in Mumbai, India.

30 Hans Tjio & Lee Suet Fern, "Developments in Securities Law and Practice" in *Singapore Academy of Law Conference 2006 – Developments in Singapore Law*

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fact that, at that time, the CIS Code did not apply to closed-end funds. It was only in 2005 that this anomaly was removed with the amendment of the definition of a "closed-end fund" in the SFA to expressly exclude a trust "that invests only in real estate and real estate-related assets specified by the Authority in the Code on Collective Investment Schemes" and that is listed on a stock exchange.[31]

23 In the first edition of the Property Fund Guidelines published in May 1999, the MAS applied a "relatively light touch"[32] approach towards S-REITs. While the guidelines covered areas such as permissible investments, borrowing limits, duties of a trustee and annual reporting requirements, the manager of an S-REIT – unlike the manager of a securities CIS – was not required to be licensed by the MAS under the SFA. Another difference was that S-REITs did not come under the purview of the Singapore Code on Take-over and Mergers (the "Take-over Code"). In the event of a takeover of an S-REIT or in a merger situation, the unit-holders of the S-REIT, particularly the minority unit-holders, might not have legal recourse against unfair or inequitable treatment.[33]

B. June 2005: MAS consultation paper, "Review of the Regulatory Regime Governing REITs"[34]

24 By June 2005, five S-REITs had been successfully listed on the SGX-ST: CapitaMall Trust, Ascendas REIT, Fortune REIT, CapitaCommercial Trust and Suntec REIT. Building on its experience of administering the Property Fund Guidelines, the MAS embarked on a review of the regulatory regime of S-REITs (the "2005 Review"), with the aim of addressing the risks that could emanate from the intrinsic dissimilarities between an S-REIT and a securities CIS. The MAS' proposals in the 2005 Review focused on, *inter alia*:[35]

(a) oversight of S-REIT managers;

(b) corporate governance practices; and

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between 2001 and 2005 (Teo Keang Sood gen ed) (Singapore Academy of Law, 2006) ("Tjio & Lee in *SAL Conference 2006*") at para 5, pp 3–4.

31 Tjio & Lee in *SAL Conference 2006* at pp 2–3.

32 MAS, *Review of the Regulatory Regime Governing REITs* at para 3, p I.

33 Koh in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 179. This position has since changed with the subsequent decision by the Securities Industry Council that the Take-over Code will apply to S-REITs listed on the Singapore Exchange (Securities Industry Council Practice Statement on Real Estate Investment Trusts (8 June 2007)).

34 MAS, *Review of the Regulatory Regime Governing REITs* at para 4, p II.

35 MAS, *Review of the Regulatory Regime Governing REITs* at paras 5–6, pp II–III.

(c) alignment of the interests of S-REIT managers and unit-holders.

25 After a public consultation exercise, the MAS announced several enhancements to the regulation of S-REITs in October 2005.[36] First, the MAS' regulatory oversight over S-REIT managers would be strengthened. An S-REIT manager should be a corporation with at least five years' experience in the management of property funds and have minimum shareholders' funds of S$1m. It would be required to maintain a physical office in Singapore, and to designate a CEO and at least two professional staff who would be based in Singapore. The CEO, the directors and the professional staff of an S-REIT manager would have to meet the MAS' "Guidelines on Fit and Proper Criteria". The Property Fund Guidelines were revised accordingly.

26 Subsequently, the SFA was amended in 2007 to include S-REIT management as a regulated activity in the Second Schedule therein. An S-REIT manager would have to hold a capital markets services ("CMS") licence to undertake the activity of S-REIT management, and all of its professional employees would need to be licensed as CMS representatives and meet the same minimum entry and examination requirements as existing CMS representatives licensed to conduct other SFA-regulated activities.

27 Further, the MAS introduced several measures to improve the corporate governance practices of S-REITs:

(a) at least 50 unit-holders, or unit-holders representing 10% of the units in issue, could requisition a meeting during which investors could query the decisions made by the S-REIT manager;[37]

(b) an S-REIT manager could be removed if this was approved by 50% of unit-holders present and voting, with no unit-holder being disenfranchised;[38]

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36 The Monetary Authority of Singapore, *Response to Feedback Received – Review of the Regulatory Regime Governing REITs* (20 October 2005) ("MAS, *Response to Feedback*") <http://www.mas.gov.sg/resource/publications/consult_papers/2005/Responses_to_Comments_20Oct05_Final.pdf> (accessed 1 June 2009).

37 MAS, *Response to Feedback* at p 3.

38 In Hong Kong, a REIT manager may be removed if there is a consensus representing 75% of the REIT's units, excluding the votes of the REIT manager, its related parties and any unit-holder having an interest in the retention of the REIT manager. In Australia, the corresponding requirement is for a consensus of more than 50% of those present and voting, with the REIT manager and its related parties who hold units being allowed to vote. After considering these models and in response to the feedback from the public consultation, the MAS decided to adopt the latter because it was regarded as being more equitable to S-REIT managers and their related parties whose interests were also at stake. See MAS, *Review of the*

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(c) in respect of an acquisition, the S-REIT manager would be required to disclose, in dollar quantum, the acquisition fee payable to it and, if a profit forecast was made, the expected incremental income to the REIT and the expected incremental base and performance fee payable to the S-REIT manager;[39]

(d) in the case of a disposal, the S-REIT manager would have to disclose the disposal fee, in actual dollar quantum, payable to the S-REIT manager, and also to substantiate why the disposal would be in the interest of unit-holders;[40] and

(e) the payment of acquisition and disposal fees to the S-REIT manager would be made in units of the S-REIT priced at the date of the transaction (at the higher of market price or NAV per unit) only in the case of interested person transactions ("IPTs"), with a concomitant one-year moratorium on the sale of those units.[41]

28 The MAS' 2005 Review also expanded the role of S-REIT trustees. Prior to this review, an S-REIT trustee, being a CIS trustee, already had to fulfil the following duties:[42]

(a) exercise due diligence in safeguarding interests of unit holders;

(b) take custody of assets and ensure that assets are properly accounted for;

(c) ensure that the property of the scheme is kept distinct from its own property and the property of its other clients; and

(d) send or cause to send accounts and reports of the CIS to unitholders.

29 Following the 2005 Review, additional obligations were imposed on an S-REIT trustee to take into account the underlying differences between ownership of properties and ownership of securities.

Regulatory Regime Governing REITs at paras 2.3–2.5, p 7 and MAS, *Response to Feedback* at p 3.

39 MAS, *Response to Feedback* at pp 4–5.

40 MAS, *Response to Feedback* at pp 4–5.

41 The MAS noted that on the one hand, paying acquisition and disposal fees in units would facilitate alignment of the interests of the REIT manager and unit-holders; on the other hand, however, it could dilute the interests of existing unit-holders. Where IPTs were concerned, however, the inherent potential for conflicts of interest could be compounded by "the subjective nature of the valuation of properties and the remuneration structure of REITs". As such, acquisition and disposal fees should be paid in units in the case of IPTs to mitigate potential conflicts of interest. See MAS, *Response to Feedback* at pp 4–5.

42 Reg 8(2)(*b*), Securities and Futures (Offers of Investment) (Collective Investment Schemes) Regulations 2005 (S 602/2005).

Specifically, S-REIT trustees would be required to perform due diligence on an on-going basis to ensure that:[43]

(a) an S-REIT has proper legal title to the properties it owns;

(b) the properties have good marketable title;

(c) the contracts entered into by the S-REIT manager on behalf of the S-REIT, such as rental agreements, are legal, valid and binding and enforceable by or on behalf of the S-REIT in accordance with its terms; and

(d) the S-REIT manager arranges adequate property insurance and public insurance in relation to the S-REIT's properties.

30 Other changes made to the regulation of S-REITs in the course of the 2005 Review included: allowing partial (*ie* less than 100%) ownership of properties, subject to certain safeguards that are common in joint-venture agreements in the property sector; increased disclosure in offering documents and annual reports of S-REITs on the tenant profile to give investors more insight into the quality of the cashflow of S-REITs; and permitting S-REITs to invest in uncompleted properties, provided not more than 10% of the S-REIT's assets are tied up in property development activities or in uncompleted property projects.[44]

C. March 2007: MAS consultation paper, "Enhancements to the Regulatory Regime Governing REITs"[45]

31 In March 2007, the MAS launched a second review of the Property Fund Guidelines and sought public feedback on several proposed changes (the "2007 Review"). Besides setting out the draft wording of the proposed SFA amendments that would formalise the new licensing requirements for REIT managers and their professional staff, the 2007 Review implemented the following measures, *inter alia*:[46]

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43 MAS, *Response to Feedback* at p 6.

44 MAS, *Response to Feedback* at pp 6–9.

45 The Monetary Authority of Singapore, *Consultation Paper on Enhancements to the Regulatory Regime Governing REITs* (23 March 2007) ("MAS, *2007 Consultation Paper*") <http://www.mas.gov.sg/resource/publications/consult_papers/2007/REITS_Consultation_Paper_Review_of_Regulatory_Regime_governing_REITs_23_March_2007.pdf> (accessed 1 June 2009).

46 The Monetary Authority of Singapore, *Response to Feedback Received – Enhancements to the Regulatory Regime Governing REITs* (28 September 2007) ("MAS, *2007 Response*") <http://www.mas.gov.sg/resource/publications/consult_papers/REITS_CP_2007_Public_Response_28Sep2007_Final.pdf> (accessed 1 June 2009).

(a) the introduction of requirements for the disclosure of short-term yield-enhancing arrangements in offering documents, circulars, announcements and marketing materials of an S-REIT;[47]

(b) granting permission for S-REITs, like business trusts, to make distributions out of unrealised or anticipated income, provided that the S-REIT manager is satisfied on reasonable grounds and in consultation with the S-REIT trustee that immediately after making such distribution, the S-REIT could fulfil its liabilities as and when they fell due out of the trust property;[48]

(c) increasing the minimum threshold for investment of an S-REIT's assets in income-producing real estate from 35% to 75%, which would be more comparable with the US (75%), the UK (75%) and Hong Kong (100%), and to sharpen the investment focus of S-REITs on income-producing real estate;[49]

(d) rationalising the responsibilities of trustees in certifying that an IPT is carried out on normal commercial terms and is not prejudicial to the interests of unit-holders and in reviewing contracts entered into by the S-REIT;[50]

(e) aligning the treatment of S-REITs with that of listed companies with respect to (i) the approval of IPTs with values equal to or greater than 5% of NAV;[51] and (ii) the definitions of "interested party", "controlling unit-holder" and "associate".[52]

32 Another consequence of the 2007 Review was the decision of the Securities Industry Council that the Take-over Code would apply to

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47 MAS, *2007 Response* at pp 1–2.
48 MAS, *2007 Response* at pp 4–5.
49 MAS, *2007 Response* at pp 5–7 and MAS, *2007 Consultation Paper* at paras 6.1–6.2, p 5.
50 MAS, *2007 Response* at pp 9–10.
51 The prevailing requirement under the Property Fund Guidelines had been that all transactions with the same interested party during a financial year would be aggregated for the purpose of determining whether the 5% threshold was reached. In contrast, r 906(1b) of the Listing Manual of the main board of the SGX-ST (the "SGX-ST Listing Rules") states that "a transaction which has been approved by shareholders, or is the subject of aggregation with another transaction that has been approved by shareholders, need not be included in any subsequent aggregation". Further to the 2007 Review, the more stringent IPT requirements under the Property Fund Guidelines would be removed and S-REITs need only comply with the SGX-ST Listing Rules in respect of such transactions. See MAS, *2007 Consultation Paper* at paras 16.1–16.3, pp 13–14.
52 MAS, *2007 Consultation Paper* at para 17.2 at p 14 and MAS, *2007 Response* at pp 11–12.

S-REITs.[53] As a result of this rule change, a party that intends to acquire 30% or more of the total units of an S-REIT; or when holding not less than 30% but not more than 50% of the total units of an S-REIT, intends to acquire more than 1% of the total units of the S-REIT in any six-month period, is obligated to make a general offer for the REIT. In Australia, REITs are also required to comply with the takeover provisions in the Corporations Act 2001; Hong Kong REITs, on the other hand, are not subject to such requirements.[54]

V. Regulatory responses during the ongoing global economic and financial crisis

33 The ongoing global economic recession, that had been some time in the making but which was precipitated by the near-meltdown in international financial markets in the fourth quarter of 2008, created unprecedented challenges for S-REITs. The response from the regulators will provide some insight and clarity as to the likely direction of S-REIT regulation in Singapore.

A. Dividend payout ratio

34 As a result of the global credit crunch, which intensified following the bankruptcy of Lehman Brothers at the end of September 2008, S-REITs faced a number of challenges which have been described as a "3-R Challenge", namely, refinancing, recapitalisation and revaluation.[55] The fall in rentals of office and retail space, as well as industrial properties, taken together with the expected supply of such properties in the pipeline, threatened to cause further strain to the balance sheets of S-REITs.

35 As a pre-emptive measure, the manager of CapitaMall Trust launched a S$1.2bn rights issue in February 2009. The success of the rights issue not only lowered its debt-to-asset gearing ratio but also significantly improved its valuations, thereby giving it more options in

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53 Securities Industry Council Practice Statement on Real Estate Investment Trusts (8 June 2007).

54 Deveson *et al* in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 16 and Leung & Smith in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 112 respectively.

55 Lim Hwee Hua, Senior Minister of State for Finance and Transportation, "Navigating the Storm: Responding to the Challenges in Singapore's REIT Market", speech at the Asian Public Real Estate Association Singapore REIT Summit (20 Feb 2009) <http://app.mof.gov.sg/news_speeches/speechdetails.asp?speechid=284> (accessed 13 June 2009) ("Lim Hwee Hua speech") at para 3.

terms of raising capital and acquiring assets.[56] In the wake of this successful fund-raising exercise, CapitaMall Trust affirmed its commitment to pay out 100% of its distributable income.[57] As at the end of September 2009, seven S-REITs had undertaken rights (or rights-cum-warrants) issues in the year-to-date, raising total gross proceeds of approximately S$3.7bn which would be used, *inter alia*, to reduce debt levels and strengthen balance sheets.[58]

36 Those S-REITs that have to manage a tighter cash position, however, could be keen to lower their dividend payout ratio in a bid to conserve capital given the difficult climate for debt refinancing; however there would be a risk that such S-REITs would concomitantly lose their tax transparency status. The Ministry of Finance and the MAS evaluated the issue and decided that the 90% minimum payout ratio would be maintained in order to preserve the key characteristics of an S-REIT as "a stable, high-payout, pass-through [investment] vehicle".[59] If these characteristics no longer applied to S-REITs, there was no strong justification for the special tax treatment that S-REITs enjoyed compared with other types of entities.[60]

37 At least one S-REIT, Saizen REIT, had seriously considered the option of distributing scrip dividends only, rather than cash dividends, as a temporary measure to conserve cash, subject to unit-holders' approval.[61] Ultimately, Saizen REIT did not follow through with the scrip-only dividend scheme.

B. January 2009: MAS circular, "Treatment of Refinancing under the Aggregate Leverage Limit"

38 Instead of relaxing the conditions for an S-REIT to qualify for tax exemptions, which could have policy implications beyond the S-REIT industry in terms of which corporate vehicles should qualify for tax breaks, the MAS provided support to S-REITs in a targeted manner

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56 Goola Warden, "Rebuilding the REITs", *The Edge Business & Investment Weekly* (20 April 2009) at 10.

57 "2009 First Quarter Unaudited Financial Statement and Distribution Announcement", CapitaMall Trust (17 April 2009) <http://capitamall.listedcompany.com/newsroom/20090417_073259_C38U_B0A117CDA53A8B0F4825759A0036D0F9.1.pdf> (accessed 26 June 2009).

58 Ascendas REIT (preferential offering), CapitaMall Trust, CapitaCommercial Trust, Frasers Commercial Trust, Starhill Global REIT, Fortune REIT and K-REIT Asia. In the case of Fortune REIT, the net proceeds from the rights issue would be deployed mainly to finance the cost of acquisitions. (Source: *The Business Times, SGXNET*.)

59 Lim Hwee Hua speech at para 10.

60 Lim Hwee Hua speech at para 11.

61 Announcement dated 13 January 2009 by Japan Residential Assets Manager Limited as manager for Saizen REIT (Source: *SGXNET*).

by facilitating S-REITs' refinancing of maturing debt. Under para 9.2 of the Property Fund Guidelines, the aggregate leverage ratio of an S-REIT should not exceed 35% of the fund's deposited property, or 60% if the fund obtains a credit rating and discloses the same to the public. On 9 January 2009, the MAS issued a circular to S-REITs clarifying that a fund would not be considered to have breached the aggregate leverage ceiling as a result of depreciation in the value of its real estate assets owing to circumstances beyond the control of the S-REIT manager.[62] The S-REIT, however, should not incur additional borrowings and crucially, the refinancing of existing debt would not be regarded as "additional borrowings". A research note published by CapitaLand Limited attributed increased bank lending to the S-REIT sector in the first half of 2009 to the MAS' intervention.[63]

C. November 2009: Introduction of mandatory AGM requirement for S-REITs

39 In May 2009, the MAS conducted a consultation on the specific issue of whether annual general meetings ("AGMs") should be mandatory for S-REITs.[64] This issue had been considered in the 2005 Review but the prevailing view then was that AGMs would not be cost effective since REITs were already conducting extraordinary general meetings ("EGMs") periodically to seek approval for their acquisitions and these provided opportunities for unit-holders to be heard and resolutions to be passed.[65]

40 In this latest round of consultation, the MAS noted that during the current economic recession S-REITs were making fewer or no acquisitions; as a result, EGMs had become infrequent occurrences and the earlier assumptions no longer applied.[66] At the same time, if S-REITs held EGMs to seek specific approval to issue new units when markets were rather volatile, this could cause speculation and have a negative impact on the unit price.[67] This concern could be ameliorated by a

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62 The Monetary Authority of Singapore Circular No CMD 01/2009 to all S-REIT Managers & Trustees approved under Section 289 of the SFA, "Treatment of Refinancing under the Aggregate Leverage Limit" (9 January 2009).

63 E-newsletter published by CapitaLand Limited, "Asian REITs Revived", September 2009 <http://www.capitalandinside.com/index.php?option=com_content&view=article&id=238:asian-reits-revived&catid=40:investment&Itemid=59> (accessed 13 September 2009).

64 The Monetary Authority of Singapore, *Consultation Paper on Mandatory AGM Requirement for REITs* (26 May 2009) ("MAS, *2009 Consultation Paper*") <http://www.mas.gov.sg/resource/publications/consult_papers/2009/AGM%20consultation%20paper%20for%20REITs%20-%2026%20May%202009.pdf> (accessed 13 June 2009).

65 MAS, *2009 Consultation Paper* at para 2.2, p 1.

66 MAS, *2009 Consultation Paper* at para 2.3, p 2.

67 MAS, *2009 Consultation Paper* at para 2.3, p 2.

requirement for mandatory AGMs during which S-REITs could obtain a general mandate for issuance of new units.[68] Imposing mandatory AGMs would also raise the corporate governance standards of S-REITs to be in line with similar requirements for listed companies and business trusts.[69] On 11 November 2009, the MAS announced that the mandatory AGM requirement would be implemented with effect from 1 January 2010, pursuant to a revision to the Property Fund Guidelines.

VI. The continued relevance of the trust structure

41 The UK was a relatively latecomer to the REITs scene and thus its choice between the corporate structure and the trust structure for REITs would be pertinent to the question of whether the trust structure continues to be relevant.

42 The UK has a long history of alternative structures for pooled investment vehicles other than the unit trust, such as closed-end investment companies (also known as "investment trust companies" and commonly referred to as "investment trusts", even though they are not "trusts"[70]) and open-ended investment companies ("OEICs"). OEICs may be considered as "corporate unit trusts" because the investor has the power to require the investment company to repurchase the investment.[71] Owing to the corporate structure of an OEIC, the shareholders would not be liable for the debts of the company; the OEIC owns the scheme property itself; and concomitantly, the shareholders of the OEIC own shares in the company but have no direct equitable interest in any specific scheme property.[72] This structure thus combines the features of a unit trust with the corporate form and affords investors the added protection of limited liability. Under the UK's financial sector regulatory framework, both unit trusts and OEICs are regarded as CIS and are regulated by the Financial Services Authority ("FSA") pursuant to the Financial Services and Markets Act 2000 (c 8) ("FSMA").[73]

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68 MAS, *2009 Consultation Paper* at para 4.2, p 3.

69 MAS, *2009 Consultation Paper* at para 4.1, p 3.

70 They are referred to as "investment trusts" under the UK's Income and Corporation Taxes Act 1988 (c 1) and as "investment companies" under the UK's Companies Act 1985 (c 6). See H M Treasury, *Consultation document on The regulation of investment trust companies* (November 2004) <http://www.hm-treasury.gov.uk/d/reginvest241104.pdf> (accessed 15 May 2009) ("*The regulation of investment trust companies*").

71 Alastair Hudson, *The Law of Investment Entities* (London: Sweet & Maxwell, 2001) ("Hudson, *The Law of Investment Entities*") at para 8.01, p 215.

72 Hudson, *The Law of Investment Entities* at para 8-07, p 217 and para 7-43, p 213.

73 *The regulation of investment trust companie*s at para 4.6, p 23.

43 Given the various structural options available to the UK's policy makers, it is noteworthy that the UK mandated the corporate form for REITs and eschewed the unit trust/CIS option entirely. Instead of adapting the existing form of OEICs to accommodate the nature of REITs (for which the closed-ended form would be more suitable), UK REITs must be listed companies *other than* OEICs, and their share capital must be limited to ordinary shares and consist of one class of ordinary share only.[74]

44 Putting aside tax advantages, there are at least three potential advantages of the corporate form over the trust structure for the purposes of a REIT:

(a) eliminating the division of roles and functions between a trustee and a manager;

(b) increasing the protections for creditors against, and in the event, of insolvency of the REIT and/or its trustee; and

(c) limiting the liability of unit-holders.

45 The SFA already contemplates the possibility of a CIS being constituted as a corporation. The term "responsible person, in relation to a collective investment scheme" is defined in s 2 of the SFA as:

(a) in the case of a scheme which is constituted as a corporation, the corporation; or

(b) in the case of a scheme which is not constituted as a corporation, the manager for the scheme.

A. Split trustee-manager duties

46 Where there is a requirement for a separation of roles and responsibilities between a trustee and an independent manager, it is unclear what duties are owed by the manager to unit-holders and creditors. Professor Tjio had previously expressed this concern in respect of unit trusts and the concern is equally pertinent in the case of REITs:

> The crucial question from a governance perspective is thus whether the bank [which manages the unit trust]/unit trust manager is itself a trustee or fiduciary.[75]

47 As both the manager and the trustee are providing specialised financial services, some overlap could be unavoidable and could give

74 Baldwin & Tidball in *Real Estate Investment Trusts* (Booth & Boyle eds) at p 204.
75 Tjio, "The Regulation of Unit Trusts" at 162.

rise to conflicts resulting from "multiple masters".[76] Where the manager takes the lead in managing trust assets, as in the case of a unit trust and that of a typical S-REIT, "the fiduciary duties of a person without legal title are of greater importance",[77] yet it is not clear what the content of the manager's fiduciary duties are and how they co-exist with the trustee's fiduciary duties.

48 Where unit trusts are concerned, the UK has aligned the accountability of trustees and managers. Section 253 of the UK's FSMA states:

> Any provision of the trust deed of an authorised unit trust scheme is void in so far as it would have the effect of exempting the manager or trustee from liability for any failure to exercise due care and diligence in the discharge of his functions in respect of the scheme.[78]

Singapore has not taken similar steps – only the CIS trustee cannot be indemnified against liability for failing to exercise due care and diligence.[79] The trustee could, however, be released from liability if the consent of the participants of the CIS is obtained under certain prescribed circumstances.

49 The Australian experience in dealing with the potential shortcomings of the division of roles and responsibilities between a trustee and a manager is instructive. In Australia, the unit trust continues to be the most common legal form for a managed investment scheme.[80] The regulation of managed investment schemes in Australia has several distinctive features, however, compared with more traditional forms of regulating CIS. These innovations were introduced in an overhaul of the regulatory framework for managed investment schemes in response to the liquidity crisis that the Australian property fund sector experienced in 1991.[81] In May 1991, the Australian Law Reform Commission ("ALRC") was tasked by the Commonwealth Attorney-General to undertake a review of:

> … whether the present legal framework for collective investment schemes provides for the most efficient and effective legal framework for the operation of the various kinds of such schemes and, in particular, whether a different operating structure should be provided

76 Sin Kam Fan, *The Legal Nature of the Unit Trust* (Clarendon Press; New York: Oxford University Press, 1997) ("Sin, *The Legal Nature of the Unit Trust*") at p 204.
77 Sin, *The Legal Nature of the Unit Trust* at p 204.
78 Hudson, *The Law of Investment Entities* at para 7-26, p 204.
79 SFA s 292.
80 Pamela F Hanrahan, *Managed Investments Law & Practice* (CCH Australia Limited, 2004) ("Hanrahan, *Managed Investments Law & Practice*") at para 1-100, p 2,101.
81 Hanrahan, *Managed Investments Law & Practice* at para 2-400, p 2,253.

> for such schemes, including whether separate structures should apply to different kinds of schemes.[82]

50 One of the specific issues that the ALRC was asked to consider was: "Should the manager (as well as the trustee) have fiduciary duties to investors?"[83] In the event, one of the key recommendations of the ALRC was that the requirement to have a trustee and a separate manager be abolished, and replaced by a single "responsible entity".[84] This recommendation, amongst others, was enacted into law via the Managed Investments Act 1998 ("MIA 1998") which commenced in July 1998. The effect of the MIA 1998 was to amend the Corporations Law by replacing the earlier provisions dealing with "prescribed interests" and inserting the new rules dealing with managed investment schemes.[85]

51 Statutory duties are imposed on the responsible entity under s 601FC of the Corporations Act 2001, including duties of honesty and loyalty, a duty to prefer member's interests and a duty not to misuse information. Officers of responsible entities (*ie* directors) "are not, by virtue solely of holding that office, in a fiduciary relationship with scheme members, and do not owe them duties as general law", but they are under statutory duties under s 601FD.[86] These statutory duties include duties to the responsible entity, duties of honesty and loyalty, a duty of care and diligence and a duty to avoid conflicts of interest. Likewise, the employees of the responsible entity are subject to limited statutory duties specified in s 601FE.

52 The statutory duties imposed on the responsible entity and its officers and employees "represent minimum standards of behaviour that cannot be contracted out of the scheme's constitution",[87] and it seems that a breach thereof may not be ratified by the scheme members. A contravention of ss 601FC, 601FD and/or 601FE carries liability for a civil penalty. Intentional or reckless breaches of these provisions would be an offence.

53 By streamlining the dual functions of a trustee and a manager into a single responsible entity and imposing specific statutory duties on this responsible entity, the Australian approach has achieved a higher degree of clarity on the duties owed by the responsible entity towards REIT unit-holders. New Zealand adopted a different approach to achieve a similar result, *viz* an express provision in s 3(2)(c) of the Unit

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82 Hanrahan, *Managed Investments Law & Practice* at para 2-400, p 2,253.
83 Hanrahan, *Managed Investments Law & Practice* at para 2-400, p 2,254.
84 Hanrahan, *Managed Investments Law & Practice* at para 2-400, p 2,254.
85 Hanrahan, *Managed Investments Law & Practice* at para 2-420, p 2,301.
86 Hanrahan, *Managed Investments Law & Practice* at para 45-100, p 46,101.
87 Hanrahan, *Managed Investments Law & Practice* at para 51-300, p 51,151.

Trust Act 1960 that the manager of a unit trust is subject to the same liability for its acts and omissions as a trustee.[88]

54 It is telling that Singapore's policy makers made a deliberate decision to adopt Australia's single responsible entity model for the new business trust structure that was introduced in 2004 precisely to "[ensure] that fiduciary responsibility towards unitholders of a business trust is clearly placed on a single entity"[89] – the trustee-manager. Unlike CIS, business trusts are catered towards closed-end investment funds that have *active* business operations. While the CIS manager is required to comply with a specific investment mandate:

> … the running of a business trust involves management of an operating business and the making of business decisions on a day-to-day basis. It would be difficult for an independent trustee to oversee the manager's business decisions.[90]

55 Since it would be more challenging for the trustee to supervise the manager effectively where the underlying assets of the fund are actively managed, it would be difficult to apportion liability between the trustee and the manager in the event of a breach of trust. As explained by the MAS in its consultation paper published in December 2003 to seek industry feedback on the proposed regulatory framework for business trusts:

> The dual-responsible entity model is more suitable to structures where the responsibilities of the trustee and manager can be more clearly set out, such as in the case of CIS, whereby the manager has a specific investment mandate. This model is less suitable for BTs. It will be difficult for an independent trustee to set similar operating mandates for a BT as it is actively engaged in running a risk-enterprise, much like a company.[91]

56 It appears therefore that the unit-holders of business trusts that invest in real estate would enjoy more protection than the unit-holders of CIS-structured S-REITs because the BT Act:

> (a) imposes statutory duties on the directors, officers and agents of the trustee-manager which are similar to the duties of

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88 Hans Tjio, "Lending to a Trust" (2005) 19 Trust Law International 75 ("Tjio, 'Lending to a Trust'") at 78.

89 *Singapore Parliamentary Debates, Official Report* (1 September 2004) vol 78 at col 360 (Tharman Shanmugaratnam, Minister for Education).

90 *Singapore Parliamentary Debates, Official Report* (1 September 2004) vol 78 at col 360 (Tharman Shanmugaratnam, Minister for Education).

91 The Monetary Authority of Singapore, *Consultation Paper on Regulation of Business Trusts* (10 December 2003) ("MAS, *BT Act Consultation Paper*") at para 7, p 9 <http://www.mas.gov.sg/resource/publications/consult_papers/2003/Regulation%20of%20BT_Consultation%20Paper.pdf> (accessed 8 June 2009).

company directors, including duties to act honestly and exercise reasonable diligence, to act the best interests of the unit-holders, and not to make improper use of their position to profit at the expense of the trust;[92]

(b) provides that in the event of a conflict of interests, the directors, officers and agents of the trustee-manager must place the interests of unit-holders before the interests of the trustee-manager;[93] and

(c) imposes criminal and personal liability on the directors, officers and agents of the trustee-manager (in addition to the risk of criminal prosecution) in respect of any gains made in breach of their statutory duties.[94]

57 Given that REITs were originally contemplated as being passive real estate investment funds, it is understandable that there is less concern over split trustee-manager duties in the case of S-REITs structured as CIS. At the same time, it should be borne in mind that firstly, whether the split trustee-manager model is ideal even for passive investment funds is debatable, as demonstrated by Prof Tjio's analysis (see para 46 above); and secondly, the impetus for reform in Australia was a crisis in the property fund industry. It has been observed that a REIT lies somewhere between the extremes of a unit trust and a business trust, depending on the extent to which the REIT is involved in property development.[95] The MAS, too, has acknowledged that REITs have "an element of active business management insofar as they engage in managing tenant mix and upgrading facilities".[96] Perhaps with the recent credit crunch faced by S-REITs as a result of the global financial crisis and where active management of the S-REITs portfolio of assets becomes critical for "survival", this question of whether an S-REIT trustee can effectively supervise the S-REIT manager has become more pertinent.

58 Adopting the corporate structure would mean a uniform regulatory treatment of S-REITs, regardless of whether the underlying assets of the S-REIT are intended at the time of inception to be passively or actively managed. S-REITs could then be given more flexibility in

92 BT Act ss 11(1)(*a*) and 11(2).

93 BT Act s 11(1)(*b*).

94 BT Act s 11(5).

95 Tjio & Lee in *SAL Conference 2006* at para 7, pp 4–5. Following the 2005 Review, an S-REIT that is constituted as a CIS may invest not more than 10% of its assets (compared with 20% previously) in uncompleted property developments. An S-REIT that is constituted as a business trust is not subject to similar operational or business restrictions.

96 MAS, *BT Act Consultation Paper* at s 10, para 1, p 32.

their investment strategies without compromising the standard of investor protection.

B. Protecting creditors against, and in the event of, insolvency

59 Adopting the corporate structure and concomitantly eliminating the requirement for a trustee and an independent manager could go some way to addressing the second issue, which is how creditors could be better protected against, and in the event of, the insolvency of an S-REIT or of its trustee. Under the present regulatory framework, the principal safeguards against the insolvency of an S-REIT take the form of borrowing limits and restrictions on riskier real estate investments such as vacant land and uncompleted property developments. It bears repeating that the Property Fund Guidelines are non-statutory, although the MAS could take into account the S-REIT's compliance or lack thereof when deciding whether to preserve its REIT status.

60 An earlier study had highlighted the risk that an S-REIT structured as a CIS could be deemed to be a void purpose trust under common law principles of trust if, to avoid stamp duty payments, the trust deed states that a unit-holder has no equitable or proprietary interest in the underlying assets of the S-REIT.[97] This language was typical in the trust deeds of the early S-REITs. Even if the structure of the S-REIT provides for certainty of objects, unsecured creditors may not have a claim on the trust assets if the trustee does not repay the loan. Despite the increasing use of the trust structure for commercial purposes, creditors' rights remain stymied by the lack of differentiation in the common law between traditional family trusts and commercial trusts, notwithstanding some judicial recognition of this distinction in *Target Holdings Ltd v Redferns*[98] with respect to assessment of damages for breach of trust.[99] For example, creditors may not claim against the trust property through subrogation to the trustees' right to be indemnified from the trust fund in the event that the debt was incurred as a result of the trustee acting improperly in administering the trust.[100]

61 Another difficulty arises from the issue of whether, and if so when, the directors of the S-REIT trustee or the manager are required to consider creditors' interests in their decision-making. In Singapore, company directors are not under a general duty to prevent the company from becoming insolvent but the Singapore High Courts have, in several cases, made it clear that directors have to take creditors' interests into

97 Tjio & Lee in *SAL Conference 2006* at pp 7–17.
98 [1996] 1 AC 421 at 435 (*per* Lord Browne-Wilkinson).
99 Tjio, "Lending to a Trust" at 81 and text accompanying n 12.
100 Tjio, "Lending to a Trust" at 75.

account when the company "is insolvent, potentially insolvent or put in a situation where its creditors will be prejudiced and the company is or [is] likely to be unable to satisfy its debts with these creditors".[101] In such circumstances, the creditors "become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets".[102] In *W&P Piling Pte Ltd v Chew Yin What*,[103] the court stated the position as follows:

> … Put another way, when a company is insolvent or on the verge of bankruptcy but not otherwise, it is the creditors' interests that are paramount (*Gore-Browne on Companies* (Jordans, Looseleaf Ed, Update 65, July 2007), vol 1 at Pt IV, ch 15, p 13).

At the same time, a form of business judgment rule has been recognised by the Singapore courts, where therefore "*[b]ona fide* entrepreneurs and honest commercial men should not fear that business failure entails legal liability".[104]

62 Where an S-REIT is facing a cash shortage, the trustee and the manager could find themselves in a challenging position of having to weigh the tax advantages that accrue from maintaining the requisite dividend payout ratio (and therefore, REIT status) against the potential for default and insolvency of the S-REIT. In such situations, it is not clear whether the creditors' or the unit-holders' interests should prevail. The split duties between the trustee and the manager could cause added ambiguity in terms of who would bear the ultimate responsibility for making the decision on dividend distributions. While para 7.3 of the Property Fund Guidelines states that the S-REIT manager may declare a dividend distribution without consulting the trustee unless the proposed dividend distribution exceeds the amount of profits, in practice it is uncertain how conflicts of opinion between the trustee and the manager over dividend distributions would be resolved.

63 In Australia, a statutory provision was introduced to make it less daunting for creditors to pursue legal remedies against the directors of the trustee. Pursuant to s 197 of the Corporations Act 2001, directors could be liable if the trustee corporation:

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101 *Federal Express Pacific Inc v Meglis Airfreight Pte Ltd* [1998] SGHC 419 at [17] (*per* Lai Siu Chiu J), referred to in *Chip Thye Enterprises Pte Ltd v Phay Gi No* [2004] 1 SLR 434 at [16] (*per* Belinda Ang J).

102 *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722 at 730 (*per* Street CJ), cited in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 at 253 (*per* Dillon LJ). See also Alexandra Loke Fay Hoong, "Chapter 8 – Directors' Duties and Liabilities" in *Walter Woon on Company Law Revised Third Edition* (Tan Cheng Han ed) (Sweet & Maxwell, Singapore, 2009) at para 8.26, p 301.

103 [2007] 4 SLR 218 at [73].

104 *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162 at [17] (*per* V K Rajah JC).

(a) has not discharged and cannot discharge the liability; and

(b) is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:

(i) a breach of trust by the corporation;

(ii) the corporation's acting outside the scope of its powers as trustee; and

(iii) a term of the trust denying, or limiting, the corporation's right to be indemnified against the liability.[105]

There is no equivalent provision under Singapore law.[106]

64 Given the division of supervisory and managerial responsibilities between the S-REIT trustee and the S-REIT manager, it would not be easy to hold the directors of either the trustee or the manager personally liable for fraudulent or insolvent trading under ss 339(3) and 340 of the Companies Act respectively. In the same vein, it is uncertain how the "clawback" provisions in the Companies Act with respect to payments made owing to an undue preference or arising from an undervalue transaction may be enforced against the S-REIT trustee in the event of the S-REIT becoming insolvent.

65 The position in the BT Act is much clearer in this regard. The BT Act contains the equivalent of ss 339(3) and 340 of the Companies Act. Therefore, an officer of the trustee-manager is both criminally liable and personally liable for any debt that he contracted without any reasonable or probable ground for expecting, at the time of contracting, that the debt would be paid.[107] He would also be liable without limitation for the debts of the trust if he had carried on any business of the trust with the intention to defraud creditors.[108]

C. Liability of unit-holders

66 While the Australian approach appears to be a neat and effective compromise between the traditional unit trust structure and the corporate structure, the latter has one additional advantage that warrants further consideration, *ie* limited liability for unit-holders. As

105 The director would not be liable on account merely of there being insufficient trust assets out of which the corporation may be indemnified.
106 Tjio, "The Regulation of Unit Trusts" at 169–170.
107 BT Act ss 50(1) and 50(2).
108 BT Act s 50(3).

noted above, creditors' rights are weaker under a trust structure than a corporate structure; on the other hand, any improvement in protections afforded to creditors could be at the expense of the beneficiaries, *ie* the unit-holders.

67 Presently, the CIS Code states that the trust deed for the following types of funds should provide that the liability of investors is limited to their investment in the scheme:[109]

(a) single hedge funds;[110]

(b) hedge fund-of-funds;[111]

(c) futures and options funds; and

(d) currency funds.

S-REITs, money market funds and capital guaranteed funds are not included in the list above.

68 The trust instrument may provide that the trustee has a right to be indemnified against the trust assets or the beneficiaries personally with respect to liabilities properly incurred in carrying out the trust and where the trustee has not breached its statutory duty pursuant to s 292 of the SFA to "exercise the degree of care and diligence expected of a trustee". As such, the unit-holders could conceivably be liable for the debts of the S-REIT because: (a) the creditors could be subrogated to the trustee's right of indemnity out of the trust property; and (b) as a matter of policy, the creditors should likewise have the ability to be subrogated to the trustee's right to claim against the beneficiaries personally, although in the case of the latter, it could be that the creditor would first have to make the trustee bankrupt.[112]

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109 See Appendices 4, 7 and 8 of the CIS Code at Appendices 4/4, 4/6, 7/2 and 8/5.

110 This is a statutory requirement. The Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (S 602/2005) require that the prospectus of the hedge fund state that investors' liability is limited to their investment.

111 This is a statutory requirement. The Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (S 602/2005) require that the prospectus of the hedge fund state that investors' liability is limited to their investment.

112 H A J Ford and I J Hardingham, "Trading Trusts: Rights and Liabilities of Beneficiaries" in *Equity and Commercial Relationships* (P D Finn ed) (The Law Book Company Limited: Sydney, 1987) at p 82.

69 Nearly two decades ago, Prof Ford and Dr Hardingham made the following case for corporatising trading trusts. The points that they raised then still resonate today:[113]

> At present, the protection of the investing public against unknowingly becoming liable without limit depends on the competence of regulatory authorities in perusing deeds and prescribing the disclosures to be made in prospectuses. Moreover, that protection is at the cost of the collective investors not having the ultimate control over the enterprise, a control which they are likely to expect because they see units as alternatives to shares. The difference between trading trusts and registered companies are highly technical and outside the understanding of not only most lay investors but also most professional investment advisers.
>
> …
>
> Would the State be too paternalistic if it said to promoters of collective public investment for trading that their efforts should be channeled through a registered company? Such a requirement would enable investors to have ultimate control of the enterprise while enjoying limits on their liability. It would also be for the benefit of creditors in two ways. First, it would attract all the rules about corporate capacity, agency and other matters which in company law make the common fund available to creditors directly. Secondly, it would attract the capital maintenance provisions in the companies legislation …

70 In practice, unit-holders of S-REITs that are constituted as CIS may not be at significant risk of being personally liable to indemnify the trustee given that there is little case law in England to support such actions against beneficiaries except in relation to bare trusts.[114] An argument has been made that the duty of beneficiaries to indemnify a trustee for expenses or losses incurred on behalf of the trust is confined to the following situations only: where (a) there is a request by the beneficiary for the trustee to assume its office; or (b) the beneficiary has an absolute interest in the trust property.[115]

71 Nevertheless, S-REIT unit-holders are in much the same position as shareholders of a company[116] and, as demonstrated above, the regulation of S-REITs and the regulation of listed companies share many commonalities. The unit-holders of business trusts that invest in real estate already enjoy statutory limited liability that cannot be

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113 H A J Ford and I J Hardingham, "Trading Trusts: Rights and Liabilities of Beneficiaries" in *Equity and Commercial Relationships* (P D Finn ed) (The Law Book Company Limited: Sydney, 1987) at p 84.

114 Tjio, "Lending to a Trust" at 111.

115 Tjio, "The Regulation of Unit Trusts" at 169 (see also Tjio, "Lending to a Trust" at n 107).

116 Tjio & Lee in *SAL Conference 2006* at para 28, p 16.

modified or excluded under the trust deed,[117] but unit-holders of S-REITs constituted as CIS are not similarly protected. Corporatisation would remove this unnecessary anomaly.

VII. Conclusion

72 A competitive tax regime and relatively "light touch" regulation have spurred the robust growth of the S-REIT sector since 2001. The underlying trust structure (or more precisely, the underlying unit trust/CIS structure), however, may be neither conducive nor suitable for future development of S-REITs if those inadequacies and inconsistencies identified above – and further thrown into sharp relief when compared against the corresponding provisions in the BT Act – are not addressed.

73 Since 1999, a number of changes have been introduced to the Property Fund Guidelines and related legislation owing to concerns which are equally relevant to listed companies, *viz* raising disclosure standards (*eg* short-term yield enhancing arrangements, tenant profile); improving corporate governance (*eg* establishing a mechanism by which S-REIT unit-holders may remove an S-REIT manager); extending the Take-over Code to cover S-REITs; aligning the interests of S-REIT managers with those of unit-holders;[118] and augmenting the Property Fund Guidelines relating to interested persons and IPTs.[119] Tjio and Lee put it this way:[120]

> … REITs are a good thing, even though it sits uneasily with extant trust, securities and tax law. But the issue for them is not one of compliance with traditional principles of trust law but of corporate governance, as is the case with all listed entities …

74 If the regulatory issues posed by S-REITs are similar to those that arise in respect of listed companies, and adopting the company form could increase the protections for unit-holders and creditors compared with the *status quo*, the question that ought to be asked is whether historical factors and tax reasons are sufficient to justify the continued use of the trust structure where CIS in general and S-REITs in particular are concerned. As described above, investors in real estate business trusts enjoy comparable protections as company shareholders, but the regulatory and tax regimes in Singapore at present appear tilted in favour of the CIS structure. Indeed, only S-REITs that adopt the CIS

117 BT Act s 32.
118 See s 3 of *MAS, Review of the Regulatory Regime Governing REITs* at pp 8–10.
119 See s 3 of *MAS, Review of the Regulatory Regime Governing REITs* at pp 10–12.
120 Tjio & Lee in *SAL Conference 2006* at para 83, p 49.

structure are permitted to use the term "real estate investment trust" and to be marketed as REITs.[121]

75 The MAS' primary reason for allowing a trust that invests in real estate to be structured either as a CIS or as a business trust is to facilitate cross-border REITs, since certain jurisdictions may only permit one structure or the other.[122] Ensuring that Singapore's regulatory regime is attractive to cross-border REITs in this highly competitive environment is indeed a valid concern. However, this justification is not entirely consistent with the underlying rationale for introducing the business trust as a new legal entity in Singapore. In the case of a new trust that is set up in Singapore to invest in real estate, it is envisaged that the decision whether to adopt a CIS structure or a business trust structure would depend on considerations as to which is more favourable from the regulatory and/or tax perspective(s). This subjects unit-holders to different levels of protection regardless of the investment objectives of the trust, a state of affairs that is not ideal because the retail investor cannot be expected to appreciate how the different legal structures affect his rights.

76 Corporatisation could result in S-REITs (that are currently organised as CIS) losing their tax transparency status if it remains the Government's policy to eschew granting tax-efficiency to selected forms of corporate entities (such as a closed-end corporate REITs) and not to other corporate entities such as companies. This reason alone could be a serious disincentive for exploring the appropriateness of the corporate structure for S-REITs. Tax issues, however, should be kept distinct from regulatory (particularly, governance) issues. The US, the UK and Australia are examples of how the regulation and governance of REITs may be aligned with company law principles without withdrawing tax transparency. Ultimately, the authorities will have to discern the appropriate balance between market development and the protection of investors and creditors.[123]

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121 SFA s 283A; MAS, *BT Act Consultation Paper* at s 10, para 2, pp 32–33.

122 MAS, *BT Act Consultation Paper* at s 10, para 2, p 32.

123 Prof Tjio has opined, in the case of unit trusts, that "the corporate form may be the best vehicle for striking a balance between the promotion of financial activity and investor protection". Tjio, "The Regulation of Unit Trusts" at 156.