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NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

July 11, 2005

Corporate Finance Division
Securities and Futures Supervision Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

RE: Consultation Paper on Review of the Regulatory Regime Governing REITs
(June 2005) (the Consultation Paper)

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) thanks you for this opportunity to submit comments on the proposal discussing the above-referenced Consultation Paper (the Proposal). NAREIT is the representative voice for United States real estate investment trusts (REITs) and publicly traded real estate companies worldwide. Members are U.S. REITs and other public businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses.

Executive Summary

In general, our comments reflect our view that Singapore can benefit from the nearly 45 years of the experience and evolution of REITs in the United States. NAREIT believes that the success of REITs in the United States is largely attributable to the appropriate flexibility of their governing rules, which generally rely on market forces rather than government-issued regulations to determine various important matters such as debt levels, internal versus external management, and whether to develop or purchase properties. Accordingly, and as further set forth below, we generally believe that it would be preferable for the MAS not to impose specific regulatory requirements as suggested in the Consultation Paper, and, instead, to let market forces guide the development of the Singapore REIT industry, especially with regard to internally managed companies.



1875 Eye St., NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 www.nareit.com

By way of background, we would like to note as well that our understanding is that Singapore REITs are established as “unit trusts” and regulated as “collective investment schemes” (CIS). As we understand it, a different regulatory framework applies to Singapore entities that are structured as corporations, or even business trusts, and the stock of which is traded on the Singapore exchange.

Our responses to the MAS’ questions are set forth below, with the appropriate question cited prior to the response.

Regulatory Framework for REIT Managers/ Aligning Interests of Managers and Unitholders

Q1: MAS seeks your views on the proposal to require REIT managers and representatives to be licensed and regulated under the SFA licensing regime and require compliance with the key criteria set out in paragraphs 1.4-1.6. If you do not agree with any of the criteria, please suggest alternatives. In addition, MAS seeks your views on whether there are any other criteria not listed in paragraphs 1.4-1.6 that a MAS licensed REIT manager or representative should satisfy.

Q2: MAS seeks your views on whether a REIT manager licensed by MAS should be required to perform any other specific activities in Singapore not listed in paragraph 1.11.

MAS also seeks your views on whether the requirement to have the activities stated in paragraph 1.11 performed in Singapore would cause any operational difficulties for a REIT manager licensed by MAS and how this could be addressed.

Q5: MAS seeks your views on the proposal to require the REIT manager to disclose, in dollar quantum, the following during an acquisition:

- (a) acquisition fee payable to the REIT manager; and
- (b) if a profit forecast is made:
 - (i) the expected incremental income to the REIT; and
 - (ii) the expected incremental base and performance fee payable to the REIT manager.

...

Q6: MAS seeks your views on the proposal to augment the Fund Guidelines on interested party transactions by requiring the following:

- (a) the REIT to obtain two independent valuations of the properties, with one of the valuers commissioned independently by the trustee;
- (b) in the case of an acquisition, the transaction price cannot be above the higher of the two independent valuations;
- (c) in the case of a disposal, the transaction price cannot be below the lower of the two independent valuations; and



(d) the trustee to provide written confirmation that it is of the view that the transaction is at arm's length and the terms are in the interests of unitholders where:

- (i) unitholders' approval for the transaction is not required;
- (ii) in the case of an acquisition, the final transaction price is not at the lower of the two valuations; or
- (iii) in the case of a disposal, the final transaction price is not at the higher of the two valuations.

If you do not agree to the above proposals, please suggest other measures that may be introduced to protect the interests of unitholders in interested party transactions.

Q7: MAS seeks your views on the proposal to extend the ambit of interested parties to include the trustee of REITs.

Although we are not extensively familiar with the regulatory framework governing Singapore REITs, we understand from an official of the MAS that Singapore REITs may be "self-advised" and "self-managed."¹ As noted below, the listed U.S. REIT industry has moved to more of a self-advised/self-managed model over the past 20 years.

Although these terms are sometimes used interchangeably, as described below, there is a difference between them. A self-**advised** REIT has its own employees who devote all of their time to the REIT just like the employees of any other publicly traded company. An externally-advised REIT typically hires a separate business entity, which can be an investment manager, bank or insurance company or an affiliate of these entities, to supervise the ongoing entity-level operations of the REIT in exchange for an advisory fee. Such advisory services include, for example, making decisions or recommendations to buy or sell a property, declare dividends, raise capital, or hire on-site managers or other employees, in all cases subject to the oversight of the company's board of directors or trustees. An externally-advised REIT can have employees as well, but it subcontracts with an outside entity for supervisory services.

Some observers believe that there is a greater potential for conflicts of interest for an externally-advised REIT than for a self-advised REIT, especially when the REIT employees own the external advisor.² In the last decade, many externally-advised REITs have addressed these potential conflicts of interest by various mechanisms, *e.g.*, requiring the REIT employees or sponsor to invest their own capital in the REIT and by linking the compensation of the outside advisor to performance-based criteria, rather than to assets owned by the REIT.

¹ If in fact, a Singapore REIT is not permitted to be internally managed under current law, NAREIT recommends that Singapore consider modifying the law in order to permit internal management. Doing so would provide investors with the maximum REIT investment choices. NAREIT does not take a position as to whether internal or outside management is the preferred structure. Instead, NAREIT suggests that both types of companies be allowed so that investors can make their own decision.

² See, *e.g.*, Susanne Cannon and Stephen Vogt, REITs and Their Management: An Analysis of Organizational Structure, Performance and Management Compensation, 10 *Journal of Real Estate Research* 297 (1995).



An externally-**managed** REIT typically is a REIT that uses outside entities (called "independent contractors") to provide on-site services to tenants at its properties. A self-managed REIT provides these services through its own employees. This definition applies to "equity REITs," which are REITs that own real estate (rather than "mortgage REITs", REITs that own mortgages). In the U.S., the Congress has permitted REITs to be self-managed since 1986, and the majority of listed REITs are internally managed. Although there is no legal requirement that a REIT be self-advised, the capital markets tend to prefer that listed REITs be self-advised. Accordingly, about 90% of the publicly traded REITs that are NAREIT members (and an even higher number of listed equity REITs) are self-advised. This number represents approximately 97% of listed REITs by market capitalization. Most non-traded REITs appear to be externally advised and managed.

Internally managed REITs do not need outside advisers, thereby obviating potential conflict of interest issues arising from internal management structures. Therefore, we do not believe that there need be any distinct regulatory supervision or rules for listed, internally managed REITs. Furthermore, we believe that the market's perception of inherent conflict of interests between REITs and their related parties, independent of any specific disclosure requirements, may lead more Singapore REITs to become internally-managed and internally-advised.

Improving Corporate Governance Practices

Q3: MAS seeks your views on the proposal to formalize in the Fund Guidelines that a [unitholders'] meeting may be convened at the request of at least 50 unitholders of unitholders representing 10% of units (whichever is lesser).

MAS also seeks your views on whether REITs should be required to hold AGMs [annual general meetings].

As you pointed out in your discussion regarding this proposal, while annual general meetings can often serve a useful function, requiring Singapore REITs to hold them could impose significant additional costs on a fledgling industry. With that said, the existing Singapore REITs do provide in their trust deeds that a meeting may be convened at the request of at least 50 unitholders, or unitholders representing 10% of units (whichever is lesser). The MAS suggests codifying this informal practice.

As with our other comments, we believe that the holding of AGMs should be governed by market forces. If the investor requests certain requirements concerning the holding of AGMs, Singapore REITs are likely to comply. Imposing a regulatory requirement of an AGM in the end may only impose additional costs on those REITs of which the market does not demand an AGM under the typical circumstances, for whatever reason. Interestingly, we understand that the five existing Singapore REITs apparently already have met these market demands of requiring AGMS under the circumstances you suggest.



Enhancing the Role of the REIT Trustee

Q8: MAS seeks your views on whether a REIT trustee should be required to perform additional obligations as follows:

- (a) a REIT has proper legal title to the properties it owns;
- (b) the properties have a good marketable title;
- (c) the contracts (such as rental agreements) entered into on behalf of the REIT by the REIT manager [are] legal, valid and binding and enforceable by or on behalf of the REIT in accordance with its terms; and
- (d) the REIT manager arranges adequate property insurance and public insurance coverage in relation to the REIT's properties.

MAS seeks your views on whether the REIT trustee should be required to perform any other specific duties.

NAREIT believes that the appropriate role of the REIT trustee, as in the case of the U.S. REIT model, is not to engage in the day-to-day oversight over the REIT, but, instead to exercise the same fiduciary and supervisory responsibilities as directors of other CIS entities. In this case, we believe it appropriate that trustees require management or the external advisor to demonstrate that it has adopted processes to verify the items in question have been resolved.

Safeguards to Address Concerns Over Partial Ownership of Properties

Q9: MAS seeks your views on allowing less than 100 per cent ownership of properties and whether the proposed guidelines for part-ownership of properties is sufficient to enable effective control of any properties held by the REIT.

When a REIT intends to invest in a property as a part-owner, it should:

- (a) make its investment by acquiring shares in a SPC [single purpose property holding company];
- (b) have freedom to dispose of its investment;
- (c) have veto powers over certain key operational issues of the SPC;
- (d) agree upfront with its joint venture partners on the minimum percentage of the distributable profits of the SPC that will be paid to its shareholders, and the REIT should be able to receive its percentage of the distributable profits of the SPC that will be paid to its shareholders, and the REIT should be able to receive its pro rata share of such dividends; and
- (e) have the right to sell its shares to joint venture partners at a price arrived at using a predetermined basis and should have the first right of refusal if its joint venture partners wish to dispose of their stake in the SPC. These rights should be encapsulated in the joint venture agreement, memorandum and articles of association or other constitutive document of the SPC.



MAS seeks your views on whether the above criteria are appropriate for partial ownership of properties. If you do not agree with the above criteria, please suggest alternatives that will address the risks of partial ownership in properties.

It is increasingly common for U.S. and non-U.S. REITs to invest in overseas properties. Further, as you point out, some jurisdictions disallow 100% foreign ownership of real estate. We would like to add as well that some jurisdictions also disallow foreign control of real estate or impose additional tax burdens on foreign-controlled real estate entities. Thus, by imposing a requirement that a Singapore REIT be able to have effective control over the properties in which it invests, the MAS may be requiring Singapore REITs to forgo investment in real estate in these countries.

We believe here, as in other contexts, that market forces, rather than specific regulatory limitations, should guide the structure of Singapore REIT investments in local, and in overseas, markets. For example, it is our understanding that many U.S. REITs already structure their foreign (and local) investments along the lines that you suggested in many instances — that is, through use of a single purpose entity over which they retain control. Nevertheless, the ability of U.S. REITs to design the structure of their investments allows them to take maximum advantage of the opportunities presented to them. We believe that by outright requiring the Singapore REIT to have veto powers over certain operational activities of the SPC, for example, or by outright requiring a right of first refusal in favor of the Singapore REIT, the Singapore REIT may have to forgo opportunities that might prove to be very beneficial for its shareholders. So long as there is appropriate disclosure by the Singapore REIT to its shareholders, the market should be able to manage the risks of the investment.

There are a number of circumstances when the suggested limitations could deprive a Singapore REIT from making a productive investment. First, it is unclear whether this limit could prevent a Singapore REIT from investing in real estate through an intervening entity. In the United States, most joint ventures are structured as limited partnerships or limited liability companies, and it is not clear whether an investment through one of these entities that then invests in an SPC would satisfy the MAS' suggested requirement that the REIT invest in an SPC.

Second, there may be tax reasons why the 50% limit may prevent the REIT from obtaining the best economic return from its overseas investments. For example, sales of U.S. real estate by non-U.S. investors usually are subject to full U.S. income tax under the Foreign Investment in Real Property Tax Act (FIRPTA) section of the U.S. tax code. However, an exception applies to sales of stock in a "domestically controlled qualified investment entity," which is defined as a U.S. REIT or regulated investment company (*i.e.*, a mutual fund) that is 50% or more owned by U.S. persons. Many non-U.S. investors invest in U.S. real estate through this structure (with a U.S. pension fund or other U.S. entity owning more than 50%) so that any appreciation in their investment is not subject to U.S. tax. Under the proposed limitations in the Consultation Paper, Singapore REITs would be precluded from investing through this tax-efficient structure, thereby decreasing net returns to its shareholders if it chooses to invest in the United States.



Third, an increasing number of U.S. REITs have found it useful to contribute some of their assets to joint ventures with institutional (including non-U.S.) investors while retaining a significant, though less than majority, share of the venture. The U.S. REITs often redeploy the funds they receive from contributions to these ventures into other real estate projects, thereby decreasing their need to return to the markets to meet their capital needs. The *de facto* control requirement could prevent Singapore REITs from using these “capital recycling” strategies.

Enhancing Disclosure of Tenant Profile

Q10: MAS seeks your views on the proposal to require the following disclosures in offering documents and annual reports of REITs:

- (a) total number of tenants;
- (b) top ten tenants, and the percentage of total net rentable area and gross rental income attributable to these top ten tenants;
- (c) trade sector mix of tenants, in terms of the percentage of total net rentable area and gross rental income attributable to major trade sectors; and
- (d) lease maturity profile, in terms of the percentage of total net rentable area and gross rental income for each of the next five years.

MAS welcomes suggestions on other disclosures in relation to tenant profile that may be useful to investors.

While we agree with you that disclosure can assist investors in making informed decisions, we believe that market forces, rather than regulation, should guide the determination of the specific items for disclosure. For example, in the U.S., the market analysts who cover U.S. REITs often receive from U.S. REITs supplemental financial information of items that are not required to be disclosed under U.S. accounting principles or securities laws. U.S. REITs willingly provide these items to analysts and the public because it assists the U.S. REITs in communicating their financial situation to the public markets. NAREIT suggests that Singapore REITs be subject to the level of disclosure as required by International Accounting Standards Board, with additional disclosure as determined by investor requests.

Development

Q11: MAS seeks your views on:

- (a) the proposal to allow a REIT to engage in the development of a property that it intends to hold in its own portfolio when completed; and
- (b) whether the proposed 10% aggregate limit on commitments in property development activities and investments in uncompleted property development is reasonable.

The U.S. experience may be instructive in this context. U.S. REITs may develop property for their own account that, once developed, they hold for investment. In the U.S. context, the relevant inquiry is whether the property is held as investment (for the long term) or as inventory



as a dealer (for the short term). This rule is desirable because it provides the flexibility for those REITs that have property development expertise to benefit their shareholders by undertaking development for their own account, thereby achieving cost efficiency and savings. This rule also helps spur development by REITs with particular development expertise in blighted areas and redevelopment in all areas. Other REITs choose not to develop for their own account.

Gains attributable to the sale of “dealer property” are taxed to the REIT at a 100% rate. Thus, the REIT faces strong discouragement, but not loss of REIT status, from directly developing property for third parties³. The determination of whether property is “dealer property” is based on the facts and circumstances of the situation, but a safe harbor is available. Specifically, the 100% tax is not imposed on a REIT’s property sales if the REIT has: 1) held the property for at least 4 years; 2) not spent, in the form of capital expenditures, more than 30% of the net selling price of the property over the last 4 years; 3) either not made more than 7 sales of property within the taxable year or the aggregate adjusted bases of property sold during the taxable year does not exceed 10% of the aggregate adjusted bases of all of the REIT’s assets as of the beginning of the taxable year; and, 4) certain other requirements are met.

Many REITs have established a core expertise in developing properties, and therefore develop properties not only for their own account, but also for third parties through a taxable REIT subsidiary or “TRS”. Profits of the TRS are taxable at the entity level, but the after-tax income of the TRS could be distributed to the REIT in the form of dividends, which are qualifying income (as described below). Thus, REIT shareholders benefit from the TRS activities and a normal corporate tax is imposed on activities not suitable under the REIT umbrella.

Additionally, in recent years, many REITs have expanded their investment portfolios through the use of joint ventures. A property owner may contribute property to a joint venture entity while the REIT contributes capital and/or manages and develops the property. By acquiring interests in properties through joint ventures, REITs greatly expand their property investment opportunities without having to secure additional capital from the public markets.

Accordingly, NAREIT believes that Singapore REITs should be permitted to develop property for their own account without limitation. At the very least, what should be excluded from any adopted limitation should be property that a REIT redevelops for its own account and pre-leased property. Because the market requires it, most U.S. REITs usually will not develop property for their own account unless it is at least partially pre-leased.

³ Alternatively, a U.S. REIT’s taxable REIT subsidiary can develop property for others or sell “dealer property” and be subject to the normal U.S. corporate tax rate of 35%.



Gearing

Q12: MAS seeks your views on the proposal to retain the current 35% borrowing limit where the REIT is not rated. A REIT may exceed the current 35% borrowing limit so long as the REIT obtains and discloses a credit rating from a major rating agency. Total borrowings shall in no case exceed 60% of the REIT's deposited property.

MAS welcomes suggestions on other disclosures that should be required to apprise investors of the risks associated with increased levels of borrowing.

The Proposal suggests increasing the statutory 35% limit on gearing to 60%. NAREIT suggests that the Commission adopt the most flexible gearing ratio possible and then let the market determine whether the REIT managers have adopted the best business model.

In the United States, REIT leverage rose to the 70%-80% range in the late 1980s and early 1990s. After the real estate downturn of 1989-91, caused in part by the U.S. savings and loan crisis, the market in the mid-1990s provided equity in initial public offerings only to those companies that used very conservative leverage ratios in the low 30% range. Since then, U.S. REITs have produced consistent operating results and both the equity markets and the credit rating agencies have become comfortable with leverage ratios in the 45-50% range. However, restricting the leverage ratios to a fixed percentage could severely limit a manager's ability to cope with changed economic conditions.

* * *

NAREIT appreciates the opportunity to provide these comments with regard to the Proposal. Please contact the undersigned at (202) 739-9408 if you would like further information or would like to discuss our comments in further detail.

Respectfully submitted,



Tony M. Edwards
Senior Vice President and General Counsel

