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Straight Talking, Bill Nowlan - The government needs to do the REIT thing to get the property investment market moving again

The setting-up of a Real Estate Investment Trust would prove to be a win-win situation for both investors and the state



Brian Lenihan: needs to help facilitate the establishment of REITs

At a recent presentation in London, a Nama senior executive used the term Real Estate Investment Trust (REIT) when referring to the possible disposal of part of its property portfolio. It struck a serious chord with me as I spent much time and energy more than 15 years ago trying to persuade the stock exchange, the Department of Finance, the Revenue Commissioners and the Central Bank to permit the establishment of REITS in Ireland in the 1990s. The stock exchange enthusiastically agreed to list REITs on the Dublin exchange but the other organisations sent us round and round in circles until we gave up. Hopefully they will be more positive this time round.

In simple terms, a REIT is a property rental business quoted on the stock exchange which gets different tax treatment to a normal trading company. This tax treatment avoids the double taxation of rental income and capital gain where property is held through a corporate vehicle.

The fundamental difference between a REIT and a normal quoted property company is that a REIT is obliged to invest mainly in rental property and not development or speculative buildings. Secondly, a REIT has to distribute 90% of its income to its shareholders each year and thirdly, it does not pay tax on its profits as would be the case for a normal corporate business.

REITs exist and operate in most other developed countries such as North America and the UK. If and when Ireland catches up with the rest of the world it will be making a facility available to investors that is well-trying and tested. In the US, REITs have become very focused and specialised: you can buy into a REIT that invests only in nursing homes, or hotels or prisons, as well as ones that specialise solely in offices, residences or shopping centres. There are of course also mixed REITs.

So what is all the fuss about? The first attribute of a REIT is that it can get the small investor exposed to property of institutional quality. Without REITs, most small investors who want to get into property have to choose between buying individual residential units, investing in property bonds backed by an assurance company, going into syndicates or taking the traditional publicly quoted company route.

Secondly, most indirect vehicles do not pay out virtually all their income to their investors but retain it for re-investment. Thirdly, most traditional property companies have high gearing, which generally leads to higher risk and share-price volatility.

Long-term savers should not be taking on significant leverage in their property portfolios and REITS are restricted as to the amount of leverage they can take on. Generally, it's less than 50% but some take on none.

Fourthly, the principal driver behind REITs is to put the investor in the same tax position as if they owned the rental property directly themselves. For example, if you own an investment property directly and receive €100 in rent, you pay tax at 41% and levies. However, if you own that property through a company, that company pays tax at 25% on its 'profits', before making a distribution to you – you get only €75 out of the €100 paid by the tenants but you then pay tax at 41% plus the levies on that €75. What this means is that you are at the maximum tax and levy rates. In the direct property ownership situation, you get a net €45 of the original €100 but if you hold through a company you get only €35. Effectively, you are paying tax at 65% and not 55%.

The double-tax bite is also there for profits from capital gains in corporate vehicles but not in REITs.

In Europe, REITs have been a traditional form of investment for professionals such as doctors and lawyers putting away money for their retirement. They buy units in the fund that in turn buys the property and manages it. REITs are suitable for retired individuals who just want income on a quarterly basis or for the small pension fund that want inflation protection and 'steady Eddie' investment strategies with no Rolls Royce driving executives. They are also suitable for large investors who want sector specialisation. Cost control is an important part of REIT management and costs should generally not exceed 5% of rental income.

What are the negatives? The first is that REITs can trade at a discount on the underlying value of property held. This can create problems in buying new properties and is partly a reflection of high property transfer duties. Secondly, the units can be illiquid when compared with normal shares. However, buying property is inherently illiquid.

Launching a REIT structure in Ireland at the present time would be very propitious. It would help Nama convert much of its and its clients' overhang of property into digestible assets for small investors, many of whom have deposits in the banks, earning 2% or so. They could earn treble that income rate from good property investment through a REIT. From the investors' viewpoint, it would be a good time to get into a market where values are at rock bottom and going only one way in my opinion – up. From the government's viewpoint, there is no downside –its tax take will not change as there is now virtually no investment property held through public companies in Ireland. There should be no loss of stamp duty revenue. We showed in our attempt to get REITs established in the 1990s that the stamp duty rate on REIT share transfers, at 1%, would be a larger source of revenue for the government due to the increased frequency of share deals as compared to individual property sales.

There are few negatives and hopefully Nama can get the necessary taxation and regulatory changes made in order to facilitate REITs, something that I failed to achieve more than 15 years ago.

Bill Nowlan is managing partner of property asset management company W K Nowlan & Associates in Dublin

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