

Reits could revive Irish investment market



State Street Bank's impressive Dublin headquarters on Sir John Rogerson's Quay in the south docklands is expected to be offered for sale at some stage by the funding bank, Ulster Bank. It was developed by Liam Carroll's Danninger company which is now in receivership. Ulster Bank is understood to have had several attractive offers for the landmark building which is now held by Dunloe Ewart Property Company. The 16,250sq m (175,000sq ft) block is producing a rent roll of over €7 million per annum. It was let by Willie Dowling of CBRE while Roland O'Connell of Savills advised State Street

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In many countries Reits – real estate investment trusts or property “stocks” – were introduced after a local property collapse, and helped restore order and activity to the market

ONE OF THE important commitments in the Fine Gael election manifesto was the promise to introduce a Reits regime in Ireland. Hopefully, such legislation will be announced in the budget.

But what is a Reit? A Reit is a property rental company which is quoted on the stock exchange and whose shares can be bought and sold in the same way as the shares in any publicly listed company.

A Reit is subject to the rules and regulation of its stock exchange which would include the obligation to publish results in a prescribed format. They generally hold more than 10 properties.

Reits pay a high dividend to shareholders as they have an obligation to distribute 90 per cent of their rental income. Dividend yields to investors are typically in excess of 6 per cent.

In Ireland, since the demise of the banks, there has been a dearth of steady, high-yielding liquid investment vehicles which have traditionally appealed to the investor looking for a dependable income.

The main advantage of a Reit compared to a traditional property company with an ordinary listing (of which there are none in Ireland any more) is that it doesn't pay tax within the company – provided it complies with the 90 per cent distribution and other qualifying rules.

However, the shareholders pay tax on the distributions as if they had received the rents directly themselves. This is not a tax shelter, as all distributed income is taxable at the recipient's normal tax rate. In effect, this puts a retail investor in the same position as a direct investor in property but with the added advantages of professional management and a diversified property portfolio.

There are Reit regimes in virtually every developed country in the world: Ireland is one of the few exceptions. Reits are used extensively in Europe for pension purposes, both to build up the pension funds prior to retirement and for income after retirement.

Reits are allowed only a limited amount of borrowing – generally not more than 40 per cent and so are quite low risk. It could be argued that, had a Reit structure been in place during the Celtic Tiger era, many Irish investors who entrusted their savings to property syndicators and the financing banks would not have been wiped out. This is because they would have had a properly regulated vehicle with low gearing to use for property investment purposes for the investors and safe lending clients for the banks.

It is worth noting that the Reit sector came through the 2008-2010 international property crisis virtually unscathed.

But why would the Government bring forward such legislation now? There are several reasons. First, it would help Nama and the banks to sell their vast holdings in Irish property back into the market (the buyers would mainly be international investors).

Second, it would establish a source of capital for the property required for new State projects. For example, the Government's programme to provide up to 200 primary healthcare centres countrywide at a cost of €1 billion could be financed by a Reit.

In the UK and elsewhere Reits provide a significant portion of the capital for nursing homes and other health facilities. This would not happen overnight in Ireland because Reits are not allowed to invest in development situations. However, they could provide the "take out" or long-term finance for such schemes.

In the US, where Reits have operated for many years, there are many specialist Reits, including Reits that provide prisons, hotels and hospitals, plus

the more normal commercial Reits investing in offices and shops. Reits are big business internationally – the aggregate value of Reits in the world is €30 billion and most major pension funds have allocated significant portions of their holdings to this asset class.

In many countries Reits were first introduced after a local property collapse, and helped restore order and activity to the sector in the years that followed. Now is a good time for Ireland to adopt this tried and tested structure for property investment.

To build up a meaningful Reits market in Ireland, apart from enacting the necessary legislation, would require that the market here establishes a good track record.

This would mean that the first Irish Reits will need to be the “plain vanilla” type – holding prime quality offices, shop and industrial properties producing high yields from strong tenants.

But once the market becomes established, which could be quite quickly, there would be opportunities for healthcare and/or similar specialist Reits.

Nama has talked about introducing Reits for some of its large apartment holdings and this would be quite feasible over time.

While the amount of cash available to invest in the initial Irish Reits is probably limited, there is a huge amount of international capital trying to get into the country to benefit from the expected significant recovery in Irish property values over the next 10 years. Such investors know that no modern country with a sophisticated economy has experienced a 60 per cent write-down in property values without a major recovery.

NCB Stockbrokers estimates that a Reits market in Ireland could reach €2.5 billion within five years.

There is no downside to Reits for the Government. After the initial establishment phase properties bought and sold within Reits will pay stamp duty and VAT in the normal way and all income will be reported to Revenue and taxed.

The upside would be the potential capital source for its healthcare and other programmes, and a method for Nama to sell some of its holding in a structured way and perhaps retaining a public holding in some of the better properties thereby sharing in the eventual uplift to the benefit of taxpayers.

A group of lawyers, accountants and other property professionals has been working on the technical aspects of an Irish Reits structure on a voluntary basis (of which I’m chairman) and has made submissions to Government proposing an Irish Reits structure that would mirror the well established international model.

Hopefully, the Minister for Finance will announce the arrival of Reits in his Budget speech and include the required legislation in the forthcoming Finance Bill.

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