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REITs will attract international investment

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Minister for Finance to introduce enabling legislation as part of the 2013 Finance Act

In his December budget, Minister for Finance Michael Noonan announced that the 2013 Finance Act would include the changes necessary to enable REITs to be introduced to Ireland. It is expected that our REITs legislation will closely resemble the UK's which was recently updated to make it more user friendly.

The name REIT is an acronym for Real Estate Investment Trust, a name coined in the US in the 1960s. The T for "trust" component of the name is no longer appropriate as REITs are publicly-listed real estate companies not trusts, but the moniker has stuck. REITS.

The distinguishing feature of REITs is that, subject to strict conditions, they are exempt from tax at corporate level on distributed income .

The rationale for this exemption is that currently the ownership of property through a corporate structure involves an additional layer of taxation compared to direct personal ownership of property.

A direct property owner pays income tax on his or her rent. However, a property-owning company is liable to pay corporation tax on its rent and after-tax rental income is then distributed as dividends to shareholders which are subject to income tax in the hands of shareholders.

This anomaly led to the demise of listed property investment companies in Ireland and the rise of the syndicate. The introduction of REITs does not amount to a tax break nor should it result in a loss of tax revenue, rather it will simply mean that the mode of property ownership (direct or via a REIT) is tax neutral.

Good governance

The conditions that a company needs to comply with to qualify as a REIT include an obligation to distribute the bulk of its rental income, restrictions on its gearing and development activities and on the extent of individual shareholders holdings.

REITs are listed companies and their shares can be bought and sold in the same way as any other share such as CRH or Ryanair.

REITs are long established in the US and throughout almost all major economies and are a globally understood and accepted investment medium. There are now 35 countries with REITs and more than 240 operational REITs with assets in excess of €1 trillon. REITs' good governance and the transparency and quality of their reporting is ensured by the industry watchdog EPRA, the European Public Real Estate. The introduction of REITs to Ireland will promote international investment in the country's troubled property sector.

In the past, the private and unregulated nature of property investment in Ireland resulted in minimal protection for private investors. All REITs will be subject to the rigorous governance of the Irish Stock Exchange's listing rules and on a voluntary, but essential, basis compliant with EPRA's exacting standards.

The REITs legislation will prohibit over-gearing and over-exposure to higher risk property development. Best practice REITs will consist of competently constructed and well diversified portfolios that will be professionally and proactively asset managed by property and specialist financial professionals.

The Irish property industry prior to its implosion was irrational. The majority of property investment deals were characterised by being overpriced, over-geared and undiversified single asset investments.

While no regulation or adherence to good practice will guarantee positive returns, rational and professional management in conjunction with conservative gearing and full information will prevent a repeat of the utter devastation of investors' equity that was a feature of Irish property market's recent collapse.

Capital appreciation

Prime Irish property is currently the focus of the attention of leading international real estate investors and is perceived as one of the most attractive markets in Europe. Its combination of high initial yield and the real prospect of significant capital appreciation (on the basis of the incipient recovery in Dublin's CBD occupational markets and, in time, market normalisation) offer investors the prospect of double-digit returns over the medium term.

The banks and Nama which take control of assets underlying their non-performing loan portfolios can use REITs as a route to market and as a component of their deleveraging strategies. In addition, they can retain an interest in the assets' upside by leaving some money on the table in the form of REIT shares.

REITs are attractive to investors because they generally pay high dividends (6 per cent+) which are highly sought after with low bond and equity income yields. And as bank deposit rates also decline, the lower net returns make meeting the 5 per cent annual distribution in Approved Retirement Funds very difficult to achieve. Irish REITs, paying high and sustainable cash yields, can fill this gap.

Bill Nowlan of WK Nowlan Property Asset Managers is chairman of the REITS Forum which is holding a conference next week (by invitation only