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RIGHTS BUT REITs

Opposing the global introduction and consequences of Real Estate Investment Trust (REITs) – Overview

What is “REIT”?

- **Real Estate Investments Trusts (REITs)** are joint stock companies that primarily derive their income from real estate i.e. ownership, operation, funding, or a mixture. They are free from corporate tax and pay out high parts of their profits.
- There are national regulations on the minimum REIT **income from and/or investment in real estate**. (USA, UK (planned): minimum 75 % of earnings, Canada: 90 % of earnings, Honkong: 90 per cent of fixed assets, Japan: 75 % of fixed assets, France: only earnings from rentals, Germany (planned): 75 %)
- They are obliged to **pay out most of their realised profits to their shareholders** (90 % in the US, 95 % planned for UK, 90 % planned for Germany, Australia: 100 %).
- The companies are **free from corporate taxes**. Investors (banks, insurance companies, pension funds, individuals) may pay taxes on received dividends according to their individual income tax rate.
- In most countries, **REITs are listed public limited companies**; however, they also exist as investment funds (“private REIT”, i.e. in the U.S.).
- In many countries there are regulations on the minimum number of shareholders or the maximum shares of one shareholder.

Who is interested in REITs?

- **Financial investors** are interested in REITs because they **perform high annual yields with limited risks**. From 1971 to 2003, the average Equity REITs annual yield in the USA was approx. 13 per cent. The “Dow Jones Industrials” increased by approximately eight per cent per year over the same period.
- **Institutional investors** (pension funds, banks, insurance companies) have collected huge amounts of capital and seek for profitable financial investments worldwide. REITs are a welcomed option in their **portfolio strategy**.
- For the **founders of REITs** (persons, banks, funds etc) are an attractive option to build a profitable business platform.
- For **Private Equity Funds** in the field of real estates REITs are a welcomed option to exit their short term engagement.
- For **owners of large real estate portfolios –companies or the public sector** – REITs are a **very attractive option to sell real estate** (housing and other). Especially if **these sales get privileged by the taxation systems** (planned i.e. in Germany).
- **States and public institutions** through REITs have an attractive option to sell out their public real estates (**privatisation** of housing, land and infrastructure) in order to improve their budget with short term perspective. By introducing REITs they may also earn from taxes paid on the sale.
- **Companies** by REITs can get rid of their “hidden beton gold” (including rental housing for employees and other obligation) and free up the capital for investments in their “key business” or other financial transaction.
- For **neo-liberals** REITs are an instrument to get rid of public engagement and introduce market relations.
- For **competing governments and global cities** REITs are an element for strengthening their financial business and stock exchanges.

What are the general risks and dangers of REITs?

- REITs lead to **loss of tax receipts**.
- REITs in the real estate sectors encourage the irreversible **replacement of long-term social investment** at low rates of profit by short-term financial investment at very high rates of profit.
- REITs **stimulate** public, municipal, industrial and other such owners to sell off and **privatise** their properties.
- REITs because of their **share holder value** orientation on high returns lead to **higher rents**, disinvestment and demolition, the splitting of rented housing into individual leaseholds and freeholds, the replacement of social housing by expensive **condominiums**, which can be followed by forced evictions.
- **Loss of social accountability**, participation.
- Loss of **local jobs**.
- Municipalities and other **public institutions lose strategic instruments** with which to promote affordable housing and socially inclusive cities.
- REITs lead to a **massive concentration of financial power** and anti- democratic political influence.
- REITs **make housing markets dependent on international speculation** bubbles.
- REITs even increase the **economical pressure** on other public real estates.

How did REITs develop?

Throughout the world REITs are playing a rapidly increasing role in organizing private financial investments in housing and cities. After a longer period of development in Northern America 19 countries introduced REITs and a half dozen are planning to do the same within the coming year.

- **U.S. Congress created REITs in 1960**, but only after the bursts of the bubbles in during the **90ies** REITs rapidly became attractive assets for speculative investments.
- **From 1971 to 2005** the number of 34 REITs with a market capitalization of \$1,5 billion jumped to a number of 197 REITs with a market capitalisation of \$331 billion. Today there are approximately **200 publicly traded REITs in the U.S.**, with assets totalling more than **\$475 billion**.
- In 2005 17 % of the US REITs were residential. Only offices were more important (19 %). With a total return of 30.4 percent, REITs in 2004 outpaced most other stock market benchmarks for a fifth consecutive year. The **dividends** come primarily contractual rents paid by the tenants.
- Since about **2004** in the U.S. more and more publicly traded REITs **"go private"**. Large share holders are taking the REITs from the stock exchange and create private REITs. One reason is the beginning burst of the U.S. housing bubble which makes the stock exchange risky. REITs within the set opportunities for investors are **just one important pawn in the game**. They create them and liquidate them depending on their current strategy to increase their returns.
- **Australia** introduced REITs ("Listed Property Trusts") in **1971**. In 2005 the market capitalisation of 36 REITs **was USD 51 bn**. Australian REITs are even active in Europe.
- **Canada** introduced REITs in **1994**. In March 2005 the market capitalisation of 25 REITs made **€12.3 bn**. There had been important mergings of large residential REITs.
- **Belgium** introduced a national type of **REITs** (Société d'Investissement à Capital Fixe Immobilière (SICAFI)) in **1995**. In Belgium REITs are limited to long-term investments. 10 REITs controle USD 4.0 bn.
- **Japan** introduced J-REITs in **2001**. In June 2005 17 J-REITs made a market capitalisation of **USD 20 bn**. During the period of J-REIT introduction commercial property (office building etc.) were most important while the invasion of J-REITs in housing hag to face difficulties because of strict **legal regulations** on evictions, the small scales of Japanese housing units

- and the limited market for high prize condos. During the past years new residential REITs appeared. It is planned to allow J-REITs for foreign investments.
- In **2001** even **Korea** introduced Korean Real Estate Investment Trust (K-REIT) and Corporate Restructuring REIT (CR-REIT). CR-REIT segment USD 5 million.
 - In **2002 Singapore** introduced REITs. 5 S-REITs controlling €5.2 bn in 2005.
 - **France** allowed REITs (Société d'investissements immobiliers cotée (SIIC)) in **2003**. 20 listed companies controlled €26 bn in 2006. Tax loss in 2004 was estimated at about €3 bn.
 - **Honkong** allowed H-REITs in **2003**. The first listed REITs in Honkong - **Link-Reit** - is based on the privatisation of public property by the Honkong government's Housing Authority, In 2005/2006 it had to face many legal difficulties because of tenants' resistance.
 - In **2006 Malaysia** was the first Islamic country to certify REITs. Malaysia even is about to become the first country in Asia where REITs conquer agricultural land (**plantation REIT**). It is expected that oil palm may be the favoured product on the 6,891ha because it's potential as a feedstock in biodiesel production. The current average yield of REITs in Malaysia stands at around 7%. The average gross dividend yield of plantation stocks is less than 3%.
 - In **January 2007** the **British** governments plans to introduce REITs. They will basically follow the US model, but private REITs will not be allowed. Companies listed at Alternative Investment Market (AIM), which include off shore companies, will not be allowed as REITs. Social housing associations are planning to transform themselves into REITs because they want to profit from the tax exceptions.
 - The **German** treasurer – although handicapped by strong critical forces – wants to be as fast as London. A draft for legislation – after a couple of delays – will include some specific regulations for housing and now expected for October or November 2006.
 - In **2007** even **India, Pakistan** and **Dubai** plan to introduce REITs.
 - In **India** it is planned to except REITs from the **stamp duty** (tax) if they buy out land. It is expected that REITs will invest in technical infrastructure and offices for the but even housing for the booming service sectors.
 - **Pakistan** wants to orientate on the Malaysia model and even plans to reduce the stamp tax. Founding of 6 REITs in Pakistan is expected within the first years. Land prizes are rocketing.
 - By introduction of Islamic REITs the **Dubai** government hopes to strengthen its "Dubai International Finance Center", a free trade zone. In Dubai real estate speculation is booming and Dubai REITs will also invest in foreign countries.
 - National REITs are **currently existing in 19 countries** worldwide.
 - The property market capitalisation of REITS **worldwide today is \$700 bn**.
 - In the **first seven months of 2006** private investors spent more on Real Estate Investment Trusts than in any period before. From January to July the transaction volume amounted to 47 billion US Dollar.

Some experiences with REITs in housing

International reporting about housing consequences if REITs is rather poor. Normally, tenants or human rights groups do not relate their struggles to macro-economical structures. However, within the past year, we had been able to establish some relations to the U.S. and Canada. Sometimes you can find news in the web.

AIMCO, USA: EVICTIONS AND CONDO-CONVERSION

- In **Venice, California** the huge US residential REIT **AIMCO evicted the social housing complex "Lincoln Place"** with originally 800 renting households.
- Lincoln Place was built in 1949 with plenty of trees and open spaces between architecturally perfect buildings. Property prices around Los Angeles rose 20% per year over the last five years. Stabilized rents in LA can only by increase by 3% each year. Since the acquisition of Lincoln Place Garden Apartments in 2003, AIMCO intends to demolish the complex and replace it with a mixture of expensive, high-rise condominiums and rentals. That plan, however,

became difficult to realize due to protests of the tenants. In addition, the apartment complex was designated as a State Historic Resource in 2005. AIMCO filed suit against the State historic commission, got the designation voided. On May 5, 2006, the State Historical Resources Commission reinstated the designation. Eviction of the remaining households at Lincoln Place is planned for September 2006.

- With **240,000 rental units**, AIMCO is the largest private apartment complex owner and operator in the USA: Their specialty: **buy-outs of HUD properties** that are being demolished to make room for more lucrative buildings. It happens in California, Dallas, Sacramento, Baltimore.

Canada: How REITs raise rents

- In June 2002 the "Canadian Centre for Policy Alternatives" reported about a **substantial rent increase in residential buildings, which had been taken over by REITs**. ResREIT, one of the largest Canadian residential REITs, took over apartment buildings with moderate rents and – by using changed legal regulations on rents – systematically implemented substantial rent increases.
- In Toronto the rents of a block with 424 dwellings, which was bought by ResREIT in 1999, jumped 22% to \$1,021 within two years. "The province's official rent Profiting from a manufactured housing crisis 3 review guideline was 2.6% in 2000 and 2.9% in 2001", Shapcott reported. "**ResREIT raised the rents four times higher than the guideline amount.**" In another 115-unit apartment building bought in 1998, when the rents were an average of \$660, ResREIT pushed up the rents 37% over three years to \$902, well over four times the official rent review guideline.
- ResREIT in 2004 merged with another large Canadian REIT, **CAPREIT**, "creating one of Canada's largest multi-family residential property owners, with a national presence from coast to coast", as their business reports praises. "The acquisition effectively doubled the size of CAPREIT's property portfolio, broadened its geographic diversification and enhanced the portfolio's quality and composition by adding a number of high-end luxury buildings situated in superior downtown locations in key cities."
- In it's annual business report even CAPREIT praises itself for having **increased the rents from the average \$877 to \$889 within one year**. Rent increase and high occupancy ratios build main strategies for the increase of the net yields. "Through its active property management strategies and proactive capital investment programs, CAP REIT strives to achieve the highest possible average rents in accordance with local market conditions", the report states.
- In 2006 Michael Shapcott reported that **in Ontario annually 600,000 tenants get evicted, because they cannot pay the exploding rents any longer**. Many become homeless. The numbers of the homeless people on the roads of the Canadian large cities increased substantial. In Vancouver, where the REITs sector and the establishment of expensive condo apartments booms, several thousand homeless people live in the streets of a threatened workers' neighbourhood. Obstructed, psychologically ill, drug-addicted house in close lanes between rotten pensions.

Praedium/Pinnacle, NYC, USA

- In **New York City** where Pinnacle Group owns over 400 rent-stabilized buildings. The properties are managed through dozens of separate limited liability corporations. **Many tenants charge that the supers do shoddy renovations, which have incurred code violations and ruined previous fixtures**. They then send **bills at inflated rates to residents**. Tenants say they have received **hundreds of eviction notices, lawsuits and harassing letters**, along with exorbitant improvement costs and rent increases beyond the legal limit. They fear they are being forced out to **make room for condos**. Two Manhattan properties, 706 and 725 Riverside Dr., have begun the **conversion process**.
- **Praedium Group** plays an important role in co-financing the business of Pinnacle Group. **Praedium runs six REIT funds** that have acquired office buildings, retail properties and multi-family homes across the country. Most holdings are in New York, California and Texas.

Invests money from pension funds, foundations, endowments and other financial firms. With \$5 billion in assets it requires a 15 to 20 percent return on its investments.

- Praedium founder Russel Appel has been outspoken about the profitability of low-income neighborhoods. "We look to take advantage of the opportunities in the marketplace," said Appel in Commercial Property News last year.

LINK-REIT, Honkong

- The first listed REITs in Honkong - **Link-Reit** - was based on the **privatisation of public property by the Honkong government's Housing Authority**. The Housing Authority controls 30 % of the housing units of the nearly 7 Mio. Honkong residents. The privatisation plan involved 180 malls, 79 000 car parking spaces, 950 000 square meters commercial land and many housing complexes. Goldman Sachs, HSBC and UBS were the joint global coordinators for the sale. JP Morgan Chase is advising the government. The plan provoked a run on the shares which were even traded at the black market before the official listing. With USD 2,54 billion shares this REIT was the largest new listing of a REIT in history.
- The plan provoked strong legal **reactions by a tenants rights group** which feared rent increases, higher prizes in the shops etc.. A 67-year-old public housing tenant, Lo, appealed to the court. She and fellow opponents claimed the deal undervalues public assets, short-changes the public and threatens to lead to rent rises for public housing tenants. The proceedings caused a delay of nearly a year for the listing of LINK-REIT. In December 2005 Lo lost the case. In Sept. 2006 six public housing residents, who have been running stalls at a market have declared a minor legal victory after successfully staving off a Link REIT management company's bid to evict them for failing to pay higher license fees.

Peter Cooper Village/Stuyvesant Town , NYC, USA

- After Metlife Inc.'s (MET, an insurance company) started the process of sale of Peter Cooper Village/Stuyvesant Town on **Manhattan's East Side** in August 2006, a couple of **REITs announced interest to take over 11,200 apartment units** over 80 acres of prime Manhattan land. The value of the property gets estimated at about \$450,000 a unit, or \$5 billion in total. About 75% of the apartment units are rent regulated, rents are roughly half the market rate.
- Rents can only be brought up to market rates when a tenant leaves, and many tenants or their families have been living there for decades. Any new owner paying the equivalent of \$450,000 per apartment is going to be eager to create a money-making luxury enclave, real estate executives say.
- The new owner could check all of the leases carefully to see that the name listed on the lease is the person actually living in the unit, press reported. "Over time, the owner could see significant 50% rent increases or more as tenants leave."
- Thus, many fear that Manhattan will lose one of its last and most important residential area which is affordable for workers, artists and the middle class. Anyway it will be the largest real estate deal in US history.

Strategies of REITs in housing

- Personnel reduction of employees
- Buying out of social, public and low-cost housing
- Violent rent increase and increase of heating costs, service charges etc.
- Massive condo-conversions
- Demolishing of affordable complexes and replacement by more profitable buildings
- Disinvestments, neglect of/worse maintenance of the housing stock
- Pressure to leave on financially disfavoured tenants, replacements by wealthy residents
- Stop of social neighbourhoods programmes, participation process etc.
- Construction on public spaces, privatisation of public spaces
- Lobbying governments for weakening legal standards
- Exit to private funds

Development and situation in Germany

- In 2004 financial lobbyist started to call for G-REITs seriously and the government started to proof it. Conservative country governments and liberals called for fast introduction. Diverse models discussed. Problems with taxation.
- In 2005 Ruhr Tenants Forum called for proofing the consequences on housing. German Federation of Tenants decided to resist REITs introduction. Ex-chancellor Schröder promised that the consequences on housing will be proofed.
- After 2005 elections in their coalition agreement Social Democrats and Conservatives committed themselves for REITs introduction after proofing the fiscal and housing risks.
- In early 2006 some social-democrat deputies published statements against REITs-introduction. During the following months the opposition inside the Social Democrats became stronger.
- Treasurer Steinbrück continued to lobby for the introduction of G-REITs parallel to the introduction in Britain at 1st Jan 2007. But he still has to face serious problems within his own party (SPD).
- The opposition within the Social Democrat deputies in the federal parliament even after many debates still is not convinced that REITs should be introduced. It seems they are not only a minority.
- The German Federation of tenants, the umbrella organisation of institutional landlords GdW, the trade unions, the Leftparty (PDS) and the Greens are against REITs.
- The Conservatives, the Liberals, parts of the Social Democrats, the financial lobby and industries are in favour of REITs.
- Steinbrück was forced to present stricter regulations on REITs and parallel announced legal regulations to limit mortgage on over-takings of housing stocks by Private Equity Funds. He meanwhile tries to argue for REITs as a more social alternative to Funds. But this does not convince the critiques.
- There still is no draft for REITs legislation. Meanwhile, it seemed that REITs cannot be introduced until January. Press last week said that the introduction will be postponed, but the ministry demented. Steinbrück says that the legislation will allow REITs retroactively for January 1st. But this hardly will satisfy the investors.
- Meanwhile one of the major funds – Fortress – is going to construct a so called “synthetic REIT”: The conquered public housing stocks will be transferred to a holding in Luxembourg (tax reduction) and then brought to the German stock exchange.
- Late October Steinbrück announced that he will present a draft for legislation to the government in October or November.

Position of Ruhr District Tenants Forum

The permission of REITs... -

- creates extraordinarily favoured taxation conditions for the massive transfer of housing and other real estates into these assets and thus provides substantial incentives for the sale and privatisation of publicly and institutionally hold housing companies, which still control 3 million housing units in Germany,
- thereby exclusively serves the interests of large financial investors, who look for high real estate profits and try to escape from the breaking real estate bubbles in North America,
- offers a profitable and welcomed exit for the short term investment by international Private Equity Funds, which bought over half a million dwellings in Germany since 2004,
- puts a burden of very high net yield expectations on transferred housing stocks, which will get realized by personnel reduction of employees, violent rent increases, condo-conversion and replacement of low-priced dwellings, neglect of maintenance, notice and evacuation of financially less strong tenants,

- threatens the housing security of millions of tenant households, heats up the rents and sacrifices the few still existing public instruments on housing markets and in town development,
- thereby even indirectly leads to a substantial reinforcement of economical pressure on housing real estates and on the so far relatively safe German housing markets, which within in short period will deliver into the cycles of global speculation,
- leads to substantial loss of taxes, which could be compensated only short-term at the price of a gigantic consumption of public fortune in consequence of the heated up privatisations,
- leads to a substantial concentration of market power on housing markets and thus to a fundamental shift of the political balance of powers, which will lead to a loss of public influence and rental protection,
- continues to disembed markets from society and by heating up speculative real estate bubbles and thus leads to risks for the entire economy,
- is redundant because of the existence of closed and open ended real estate funds in Germany.

REITs are suitable to destroy the remainders of social housing industry which we still have in this country. They serve the interests of financial investors, who do not invest in productive plants, but speculatively cannibalise social fortune.

(from a recent Open Letter to treasurer Steinbrück)

Alternatives to REITs-Introduction

- Reform, re-strengthening and optimisation of public/social housing and it's organisms instead of sales and privatisation.
- Creation of incentives for optimisation of social operations by the public housing industry instead of creation of incentives for sales and privatisation. Measures in this direction could result in the creation of a new adjusted and tax-privileged housing sectors (new non-profit character).

Measures combined with/after REITs-Introduction

- Improvement of tenant and consumer protection
- Strengthening of town planning instruments
- Extra taxation on income from REITs
- Stricter financial regulations on REITs: maximum shares, obligations on reinvestment – less strict obligation on paying dividends..
- Exclusion of housing, exclusion of public/social housing from REITs
- Specific legal protection for tenants
- Possibly, the creation of alternative platforms, which correspond to social criteria. In the USA there are some isolated considerations about "ethical REITs ", which commit themselves to social and ecological standards and goals as well as a regular monitoring. Such requirements should be legally adjusted. Of course the economic net yield would be smaller.