Analysis of the development of REIT in various countries to provide ideas for China's trust fund market

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Abstract. With rise of economic level and the development of society, decreasing in Engel's coefficient, people's financial awareness and financial concepts have changed a lot. As one of the four pillars of finance, trust plays an important part in financial system. Compared to other three financial pillars, Banking, Insurance and Securities, there is no special regulatory authorities for the trust industry, and the relevant laws and regulations have not been improved. This paper focuses on studying the REIT markets of England, America, Japan, and Australia these four overseas countries in order to learn more about the development of mature REITs market and summarize the main features in order to provide references and ideas for the benign development of China's REIT market.

Keywords: Trust; REIT; Fund market.

1. Introduction

For the Chinese people, "Trust" is a new word. After all, it has been in the limelight for only 20 to 30 years. Actually, "Trust" has different meanings in different circumstances. Above all, the trust legal system, which the most fundamental starting point of the trust. This is the legal aspect of understanding trusts. Secondly, the trust company, which refers to financial institutions that use trust legal relationships to conduct business. Then, the trust product, such as trust beneficiary rights, trust units, which point to the specific financial instruments. Last, the trust business, which is connected to the business form and the business model.

In terms of the kernel of the legal mechanism, the trust originated from the English usufruct system, which was designed for medieval English people to avoid heavy feudal taxes, prevent the confiscation of land due to defeat in the Wars of Roses, circumvent the primogeniture system, and circumvent the law to insist on making donations to the church. In the long term, the usufruct system developed into the trust system.

In 2000, China has introduced the trust system and promulgated the law of trust, in which it defined Trust as: "Trust is an act whereby a principal entrusts his property to a trustee, based on his trust of the trustee, and the trustee manages or disposes of it by using his own name for the benefit of the beneficiaries or for specific purpose, in accordance with the wishes of the principal." There are four features of the trust system are mentioned in this law: Trust-based, property-based, trustee-focused, and principal-focused. There is no doubt that the trust system satisfied various kinds of needs in socio-economic life, and demonstrated the irreplaceable role of other legal systems.

Since 2001, when the trust system was formally introduced in China, trusts have been developed for more than two decades. However, most of Chinese people are still know very little about the trust industry. It is urgent to clarify the business logic and the development rules of trust through the joint efforts of all parties to promote the prosperous development of Chinese trust companies and even the Chinese financial market.

2. Operating model of asset management

Asset management is a process that clients hand over their own assets to professional financing manager or institution, so that it can be put into the capital market for earning investment profit. This kind of business is based on the premise of signing a management contract, compared to pure investment capital market, asset management has a lower profit and a lower risk of management. Asset management mainly has three forms: provide directional asset management service for individual client, provide collective asset management service for multiple clients, and provide special asset management for specific target client [1].

Trust investment fund is a way of asset management business, and the essence of asset management business is actually a combination of pool operation and portfolio investment. Usually, the trust company first understands the financing clients' economic and family situations, finds their financial goals, analyzes their investment needs, designs personalized products with set investment scope and investment strategies for them, and allocates trust funds to assets with value preservation and appreciation functions [2].Finally, the products are then sold to the clients.

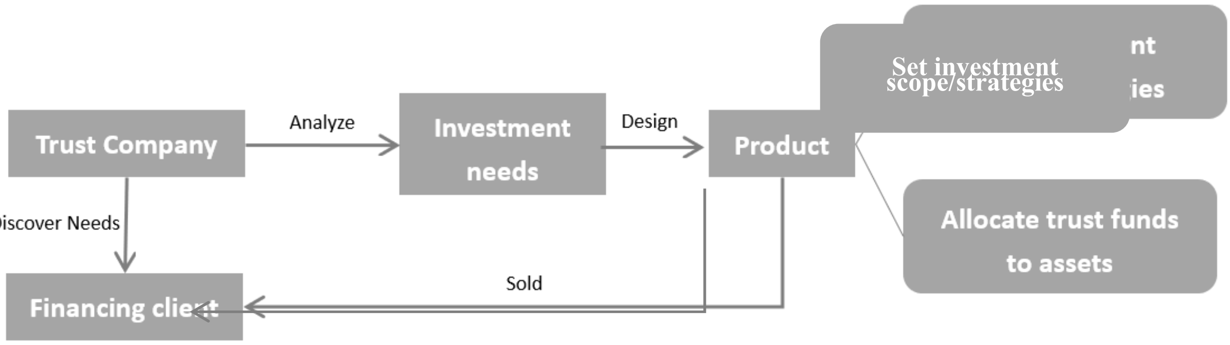

Fig.1 Trust Investment Fund Process

In essence, the asset management business of trust companies is not very different from that of other institutions, except that the asset management business of trust companies is based on a fiduciary relationship. A professional manager or management institution uses a combination of different financial instruments such as funds, insurance, stocks and bonds to diversify risks and maximize the value of assets.

However, Real Estate Investment Trusts (REITs) which as an innovative financing mean in real estate enterprise, is different from other financial tools. Actually, REITs is a kind of asset bonding, which supported by specific asset corporation to issue tradable securities. Above all, the originator determines the assets that can be bonded. Then, the originator establish the Special Purpose Vehicle (SPV) to sale asset bonding to SPV truly (or SPV also can purchase asset bonding actively) , in order to gather all asset as a asset pond. Next, professional individual or group may estimate or enhance the credit of asset to support effective securities issued in the financial market by using the stable cash flow which produced by this asset. Finally, the cash flows generated by the asset pool are used to liquidate the valid bonds that have been issued [3].

3. Development of REIT in different countries

3.1 Development of REIT in the United Kingdom

As one of the major birthplaces of the trust industry in the world, the UK has a more mature capital market and technological advances have brought it a strong capital base. However, because of imperfection of relevant laws, the market was never established until the publication of finance bill which included legislation related to REIT in 2006. It caused that the development of trust in England started more than a decade later than other European countries, especially the Netherlands and Belgium [4].

In 2008, under the impact of financial crisis, the demand for rental properties slowed down and portfolio valuations fell down, the development plan of the UK REITs put on hold. In this situation, unemployment rate rose sharply, prices bulk commodities fell a lot. In order to help the development project push toward a healthier market, real estate enterprises chose to wait and limit the maximum cost. In addition, managers of real estate investment trusts company tried their best to reserve cash and decrease debt for making a good use of the opportunity of real estate values decreased, in order to purchase distressed assets in the future [5].

EPRA global Real Estate Investment Trusts index at the end of the second quarter of 2017 said that: “the value of the total listed real estate sector in Developed Europe was USD 447.61 billion. Largest markets are the United Kingdom (USD 92.78 billion)......” [6] According to this information, it is obvious to see that the real estate industry in the UK plays an important role in domestic economy and international economy. REIT in the UK is getting more and more attention from investors. Moreover, the pension of the UK are managed by trust enterprises, it may help England’s REIT will be better known by more people and become more and more popular among the investors.

In the tax system, rental income form real estate properties can cover the corporate income tax. In this way, there are no tax on basic gains realized from the disposal of assets. In addition, detail and serve regulation is beneficial to avoid double taxation, and even giving REIT of the UK tax breaks. It is effective for the United Kingdom to support the REIT market has a bright future.

3.2 Development of REIT in the United States

In 1960s, as one of the major countries of establishing real estate fund, American real estate industry had a series of problems such as high requirement of profession, great need of capital, strong regional feature and poor liquidity. In order to solve these problems, there are some REIT which managed by professional real estate companies emerged in the United States of America [7]. With the emergence of REITs, most of investors were attracted to invest portfolio item to reduce risks effectively and to gain a higher profit. In the real estate investment, the income of investors not only from rental fees, but also from the added value of the real estates themselves. Besides, the tax policy supports the development of real estate investment in the United States as well. These further increased people’s investment efforts.

What is unique is that the investment staring amount is lower than other financing assets, decreasing the threshold of investment significantly, which means small and medium investors can put their money into the real estate industry also. In this way, the mobility of REIT in the United States improved a lot. On the other hand, the relevance between REIT and other financing assets is not significant, it is a good way to use REIT to realize portfolio investment and diversification [8]. At the same time, the resulting economies of scale, helped larger investment trusts of real estate bring a bigger return, until the economies of scale run out.

In 1986, after the tax reform act, which allowed REIT to manage in-house autonomy, in order to enhance the possibility of increasing stakeholders’ profit. It encouraged real estate investment trusts managers’ decision-making efficiency in daily operational process. In this situation, REIT in the United States went beyond acquiring and securing exiting real estate capable of generating income, instead of choosing to stretch the industrial chain, such as acquisition for land, collection of rent and property management fee. Vertical integration like this, caused the flexibility of REIT improve a lot, give a better adaption for market change and earn profit. Taken this opportunity, individuals and investors who are interested in real estate industry had better to think about significant strategy of investment.

3.3 Development of REIT in Japan

Japan is the most distinctive country in the world for the development of the real estate investment trust industry, which originated in the United Kingdom and the United States, and began in the early part of the last century. Although Japanese trust industry started later than other European countries, its developed rapidly.

With the promulgation of Trust law and Trust industry law, Japanese trust industry officially entered a new era. However, due to the signing of the Plaza Agreement, the Japanese yen rose apace. Assets consisting of U.S. Treasuries incurred a book loss, amount of capital flowed into Japanese market for avoiding exchange rate risk. Japanese government started to implement the financial easing policy, caused excess liquidity. Moreover, Japanese banks tended to finance real estate, retail, personal residence and sectors. Because of these two factors, there was a speculation boom in Japan, significant increase in the volume and of transactions in the land market, also the price of land went up a lot. Therefore, the increase in the book property of landowners stimulated the desire of consumption and higher domestic consumer demand, further boosting the development of economic. In the long run, land price have far exceeded actual demand, rising asset prices could not be supported by industry. Japan's bubble economy burst.

Affected by the bubble economy, Japanese investment market confusion. Investor's perception of real estate investment has changed a lot, Japanese people have developed a shadow of distrust in the real estate market, so the desire to invest was low. The development of REIT in Japan had been difficult against the backdrop of uncertainty in both the psychological and economic environment [9].

In order to change this situation, Japanese government strengthened the threshold restrictions on the trust industry, and established better legislative protection for the trust industry. With the help of a well-connected network of services, Japan developed a special trust business that was suited to country's context. For example, the real estate company sells the land and building to the investor, and the investor pays the real estate company the price of the land and building [10]. It provided a sufficient start-up capital for Japanese long-term economic construction.

3.4 Development of REIT in Australia

After Australian stock market crashed in 1987, a large amount of capital flowed from the stock market into the unlisted real estate investment trust product market, made this market gradually expand a lot. Under the exploration, research and practice for many years, REIT in Australia (A-REIT) has already formed a certain scale and become mature.

In the early 1990s, due to the inability to meet the legal requirement of 60 days to liquidate, the entire market was paralyzed [11]. For improving the mobility, Australia implemented the deregulation, which made a profound reform of the financial markets. In this deregulation, Listed Property Trusts (LPT) can trade in the secondary market, which brought a swift expansion of Australia REIT market. Then, because of the effect of the economic recovery and new immigrants moved in, the scale of real estate market increased, and the A-REIT had a further expansion.

However, due to the huge impact of the Asian financial crisis, most of investors were seeking for a safe investment objective to spread risk as soon as possible. So, a great amount of funds transferred from traditional stock market to A-REIT market, led to take an extremely active part of financing transactions.

In order to reduce the operational cost, some large scale real estate companies chose to expand their scale by purchasing small REIT, and even merger and reorganization. The performance of A-REIT improved a lot by listing with a joint venture with a top- performing company. Under this structure, fund managerial company were mainly responsible for the development and construction of real estate, and the rental collection property was held by REIT. In this way, the attraction of investors enhanced a lot, meanwhile, it is a good method to evade legal restrictions on active development and non-reliance on stable cash flow investment reasonably by consolidating expansion of investment scope and investment areas.

In addition, the advantage of tax aspect is significant as well. In order to encourage domestic development of REIT, Australian government stipulated that, if a single fund product has more than 300 investors and the funds under the products are invested in mature properties with cash flow, the fund is exempt from transaction stamp duty. Besides, REIT fund management fees are not subject to goods and services tax (GST), and the investors' capital gains are taxed by half [12]. With the support of such a policy, the real estate market in Australia has a prosperous development.

3.5 Summary

According to the content above, it is obvious to see that the support of policy make a momentous contribution to the development of real estate investment trusts industry. In England, America, Japan and Australia, supports of government are the basic reason for real estate industry's success. Also, legislative improvements are a key enabler for further REIT development.

However, the speed of development of the REIT market is inextricably linked to the social environment, cultural environment and investors' desire to invest. And international environment and exchange rate also make a giant impact to people's investment psychology and the adequacy of funds.

4. Analysis of Chinese REIT market

Since the promulgation of the Trust Law of the People's Republic of China, Chinese trust companies have made great strides. Chinese trust enterprises have made many innovations in meeting the market demand and the desire for self-development, which played an active role in the development of Chinese economy. However, the trust industry faces great difficulties in the new situation: With the rapid development of social economy and continuous improvement of the legal system, the problems of real estate trust market became more and more obvious. Because of the external constraints, Chinese trust companies have objectively confused some financial concepts, which could be a potential cause of financial confusion and risk.

On the one hand, the information of trust lacks of symmetry. In the trust industry, the threshold for investors is higher than other financial items, and the amount of capital required for investment is large, which means the trust faces a higher target group of clients. Also, penetration of trust business in the Chinese market is low, caused people know little about this kind of investment path. On the other hand, inadequate laws and related policies make people are worried about the risk of investment, and hesitate when investing [13].

According to the analysis of development of REIT in overseas countries, it is obvious to see that policy and legal support are the key elements for the trust to achieve development.

Therefore, for government, they had better improve relevant laws and regulations as soon as possible in order to provide legal protection for investors. Better supervision of trust companies by the relevant authorities is also a good way to reassure investors. Besides, except the good investing environment, sufficient disposable income is the basic factor for investors' investing desire. So, it's necessary for government to improve the social security mechanism.

For trust companies, innovating trust product model satisfies different kinds of people's needs and has a close connection with clients. For example, integrating trust products into daily life (i.e. UK uses trust funds to pay out pensions.) can greatly enhance people's understanding of the trust industry, and increase the popularity of trust. In this way, people will spontaneously gather information about REITs.

Besides, the development of REIT business can not be achieved without excellent trust talents. For employees of real estate investment industry, construct a sound talent training system to cultivate composite talents who are proficient in real estate investment business. Avoid the problem of specialized financial management that is not professional because of the lack of talents, and provide talent guarantee for the Chinese REIT industry.

5. Conclusion

From the analysis in this paper, we can see that there are still some problems exist in the current REIT market and need to be solve urgently. Drawing on the successful practices of overseas REITs, studying the laws of development, taking into account China's national conditions and the needs of China's economy and society for special finance, and critically inheriting and absorbing the experience of overseas REITs. In this way, REIT market in China can attract more investors to participate in, achieve a long-term development, and facilitate an excellent improvement of Chinese real estate industry. Let's look forward the prosperity of REIT in China together.

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