Financing Real Estate through Capital Markets

Real Estate Investment Trusts (REITs) are real estate financing vehicles that are modelled after mutual (or unit trust) funds. REITs own, and in most cases, operate income-producing real estate projects. The REITs structure are created to provide all type of investors (private individuals and institutions) the opportunity to invest in large scale, diversified portfolios of income producing real estate in the same way they typically invest in other asset classes – through the purchase and sale of liquid securities. REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centres, hotels, etc.

It can therefore be correctly argued that REITs provide a practical way in which all investors who have interest in investing in real estate sector within the economy can invest in large scale, income producing, professionally managed companies that owns commercial (and in some cases residential) real estates.

REITs can be publicly or privately held. Public REITs are listed into stock exchanges. As of mid-2012, there were more than 410 real estate companies from more than 37 stock exchanges representing an equity market capitalization of more than US$ 1 trillion (more than 80% of these were REITs).

The genesis of the REITs can be traced back in 1960 where through a legislative action the U.S Congress gave all Americans – not just the affluent few – the opportunity to invest in income-producing real estates in a manner similar to how individual and institutional investors invests in shares and bonds. Income producing real estates refers to land and the improvements on it – such as construction of apartments, offices, industrial facilities and hotels. REITs may invest in properties themselves, generating income through collection of rent, or they may invest in mortgages or mortgage backed securities tied to properties, helping to finance the properties and generating interest income from lending.

In most emerging and developed economies REITs own many forms of the shopping malls, apartment building, students hostels, homes, medical facilities, office building, hotels, cell towers, etc. In these markets REITs contribute significantly in jobs creation and investment income to national economies.

REITs have diverse profile that offers many benefits. REITs are often classified in one of two categories: equity REITs or mortgage REITs. Equity REITs derive most of their revenue from rent. Mortgage REITs derive most of their revenue from interest earned on their investment in mortgages or mortgage-backed securities.

REITs have many potential advantages those who have interest in the real estate sector i.e. real estate developers, investors, and the economy. I will mention a few: (i) Diversification: Equity REITs may invest in many different properties in different geographical locations within the country, bringing investment diversification by property and geography to investor portfolios; (ii) Dividends: REITs are usually required to pay a large percentage of their taxable income as dividends to shareholders who in turn pay income taxes on those dividends; (iii) Liquidity: Publicly traded REITs shares can easily bought and sold; (iv) Performance: Over the past 30 years, publicly traded equity REITs outperformed the leading stock market indices, including the S&P 500, Dow Jones Industrials, NASDAQ Composite, etc; (v) Transparency: Publicly traded REITs operate under the same rules as other public companies for securities regulatory and
In 2011, the Capital Market and Securities Authority put up the regulatory framework (The CMS Collective Investment Scheme - Real Estates Investment Trust Rules of 2011 – these rules are published in the capital market and securities authority (CMSA)) to enable capital raising and financing real estates projects through REITs. This legal framework, among other aspects provides rules relating to eligibility, responsibility, key players, listing procedures, operationalization of REITs, etc. We, at the stock exchange have a trading platform (infrastructure) to facilitate such capital raising approaches.

So, the legal framework and the infrastructure to enable operationalization of the publicly listed REITs are available, therefore property and mortgage developers such as the National Housing Corporation, Pension funds, and other such institutions may consider making use of this platform to facilitate not only in enabling private individuals (retail investors) and professional institutional investors to invest and have ownership in the vibrant real estate industry but also enable real estate developers to access more efficient, effective, better priced and less costly public funding for speedier development of properties and mortgage, being either housing, commercial or industrial properties. In actual fact, less costly funding means lower cost for houses and commercial or industrial properties and hence more affordable houses, office space and industrial properties in our economy.

Once issued in the primary market, units and/or shares issued by a REIT will be listed on the exchange to enable tradability and liquidity creation between and among investors. REITs are highly liquid method of investing in real estate. Private individuals (retail investors) can invest in REITs either by purchasing their shares/units directly during the IPO or on an exchange after listing or by investing in a mutual fund that specializes in real estate. Investing in a listed REITs is a liquid, dividend-paying means of participating in the real estate market for retail investors (private individuals) and institutions with interest in participating in the real estate industry. For pension funds, this may also be one of the effective mechanisms to enable their members to participate in the ownership of assets created by their contributions.

Recent data issued by the Bank of Tanzania (BOT) indicates that the country’s mortgage size is only about US$ 100 million, less than 1% of the total commercial banks lending book and about 0.4% of our GDP! – can listed REITs be a solution to real estate funding and development to our country?

I believe that with the existing progressive accumulation of trust in the financial system coupled with the housing finance and pension sector reforms the REITs structure can appropriately be considered by most of us as a means of economic inclusion and empowerment, wealth creation, welfare enhancement, capital market development and economic development.

Lessons from other African countries with relatively similar economic aspects to our own, Ghana’s Home Finance Company (now HFC Bank) established its first REIT in 1994. HFC Bank, as the forefront of mortgage financing in Ghana has successfully been using various collective investment scheme, of which REIT is part of, and are regulated by the Securities & Exchange Commission of Ghana.

In 2007 the Securities & Exchange Commission (SEC) of Nigeria set and issued guidelines for the registration, issuance and operationalization of REIT. The first successful REIT was launched in 2008 enabling the Union Homes Hybrid Real Estate Investment Trust to raise N50 billion.
In Kenya, the capital markets regulator –CMA- have from December 2013 to date licensed five companies to manage REITs in their preparations to launch REITs products in the Nairobi Stock Exchange later this year.