REITs: Unlocking value in real estate

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The STANLIB Fahari I-REIT has become the first REIT to receive Capital Markets Authority (CMA) Approval and is on course to be Kenya's first listed property income fund.

REITs allow investors to share ownership in large real estate properties like major office buildings or hotels that would otherwise be difficult to afford. Investors buy units in the REIT and earn dividends based on the value of their investment and the income performance of the trust. REITs offer high liquidity, relative to outright real estate ownership, by enabling investors to sell units quickly.

Another benefit is the tax exempt status accorded to REITs. Payments for redemption of units or sale of shares received by unit holders or shareholders are exempt from tax on capital gains which was recently re-introduced after being suspended for three decades.

Legal form

A REIT may be structured in two forms:

- D-REIT: A development and construction real estate investment trust; or
- I-REIT: An income real estate investment trust.

A REIT is structured as an unincorporated common law trust which is divided into units, established under a trust deed and has a trustee who is independent of the REIT, manager and the promoter. It also must have a REIT manager and a trustee who are licensed persons.

A REIT can be open ended or close ended. An open ended fund means a person may acquire additional units from time to time and dispose of them by having the units redeemed by the trustee. The size of the fund may expand or contract as investors acquire or dispose units. The value of units

in an open ended fund is determined by the net asset value of the fund. On the other hand, in a close ended fund, the number of REIT securities issued remains constant over time except where a new issue of REIT securities is made or there is reduction in the capital of the fund initiated by the trustee or as a consequence of termination or winding up of the trust. The value of the units in this fund is driven by investor demand.

Taxation of REITs

The income of a REIT registered by the Commissioner is exempt from income tax except for the payment of withholding tax on interest income and dividend. However, withholding tax does not apply in cases where the REITs unit holder or shareholders are generally exempt from tax. Unit holders who are exempt from tax may include among others registered retirement schemes.

In addition, payments for redemption of units or sale of shares received by unit holders or shareholders are exempt from tax on capital gains which was recently re-introduced.

With regards to VAT, rental income earned from the sale, renting or leasing of non-residential premises would be subject to VAT. The sale, renting, leasing, hiring or letting of land and residential premises is exempt from VAT. In addition, if a REIT has been set up as a charitable organisation and it obtains tax exemption as provided under the Income Tax Act, such a REIT will also be exempt from VAT on the supply of social welfare services which are not made by way of business.

Offers in respect of a REIT

An offer or an issue of REIT securities shall be made either as

- A restricted offer to professional investors in accordance with an offering memorandum; or
- An unrestricted offer in accordance with a prospectus.

A "professional investor" means any person licensed under the Act, an authorized scheme or collective investment scheme, a bank or subsidiary of a bank, insurance company, co-operative, statutory fund, pension or retirement fund; or a person including a company, partnership, association or a trustee on behalf of a trust which, either alone, or with any associates on a joint account subscribes for REIT securities with an issue price equal to at least KES 5 million.

Capital requirements

The minimum value of the initial assets of a real estate investment trust in a D-REIT is KES 100 million and in an I-REIT is KES 300 million.

Listing requirements

D-REITs may only be offered as a restricted offer to professional investors and can only be listed on a market segment of a securities exchange approved by the CMA which limits trading to a restricted minimum parcel size of KES 5 million. I-REITs on the other hand may be offered as a restricted offer to professional investors in accordance with an offering memorandum (in which case the foregoing restrictions apply) or as an unrestricted offer in accordance with a prospectus. The STANLIB Fahari I-REIT has chosen the latter option thus allowing a lower minimum subscription of KES 20,000.

Asset/Income/activity tests

The trustee of a REIT may invest in:

- Eligible real estate directly;
- Eligible real estate assets through investment in an investee company incorporated in Kenya which directly owns the eligible real estate and which is wholly beneficially owned and controlled by the trustee in its capacity as the trustee of the REIT;
- Eligible real estate assets through an investee trust in which the trustee of the REIT in its capacity as trustee is the sole beneficiary and has absolute control of voting and right to appoint and remove the trustee of the investee trust;
- Cash, deposits, bonds, securities and money market instruments;
- A wholly beneficially owned and controlled company subsidiary which conducts real estate related activities; and
- Other income producing assets including shares in property companies incorporated in Kenya whose principal business is real estate related or REIT securities in other Kenyan REITS, provided that the shares or REIT securities are listed on an approved securities exchange.

An I-REIT shall in each financial year after the second anniversary of its authorisation earn at least 70% of its income from rent, licence fees or access or usage rights or other income streams of a similar nature generated by eligible investments in income producing real estate. Any profits or capital gains from the sale of real estate shall be excluded in determining the income of the I-REIT.

Distributions

The trustee may only make distributions to REIT securities holders from realized gains, realized income or from cash held in the fund which is surplus to the investment requirements of the trust. The trustee of an I-REIT shall, subject to a higher minimum being specified in the scheme documents and to the provisions of the CMA Regulations, distribute, within four months after the end of each financial year, a minimum of 80% of the net after tax income.

For a D-REIT, where the trustee is of the opinion that the level of distribution recommended by the REIT manager is not in the interests of REIT securities holders, the trustee shall call a meeting of REIT securities holders to approve, by way of ordinary resolution, a lower distribution.