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Governance of trusts: sunny, with a chance of isolated showers

By Mak Yuen Teen and Chew Yi Hong

LAST year, we launched the Governance Index for Trusts (GIFT), the first-ever published governance index in Singapore that is specifically developed for listed real estate investment trusts (Reits) and business trusts (BTs) in Singapore. GIFT assesses both governance and business risk factors. We assessed 43 trusts.

This year, we covered 44 trusts, comprising six that are constituted as stapled securities (SS), nine pure business trusts and 33 Reits. We excluded four newly-listed trusts that have not yet published an annual report at the cut-off date.

Some changes were made to the index, including the addition of a small number of new demerit criteria, and replacing volatility of returns with a criterion relating to foreign assets and foreign currency risks in the business risk area.

For this year's assessment, we also contacted all the trusts that have published email addresses for their investor relations function, inviting them to complete a self-assessment using the revised scorecard. This was done primarily to increase the engagement with the trusts and provide an opportunity for them to use the scorecard to reflect on their governance. We reviewed the self-assessment as part of our independent assessment. As the assessment for GIFT is based on publicly available information available to investors and other stakeholders, our independent assessment may not necessarily be the same as the self-assessment provided by the trust. We are delighted that 29 out of the 43 trusts we were able to contact by email submitted a self-assessment.

We also released GIFT slightly later this year so that we could include the latest annual reports for trusts with a March year end. For these trusts, we used the annual reports released as late as July 2018. This allows us to use the most updated information possible for the financial year under review to assess the trusts.

How the trusts fared

The total overall score (including merit and demerit points) ranged from 40 to 79, with a mean of 65.5 and median of 68. Compared to last year, the mean has improved by 3.5 points and the median by 6 points.

While the scores are not strictly comparable to last year's since the index has been refined slightly, it is clear that there has been an overall improvement. Average scores have improved in all areas, except for internal and external audit, where the already high average score last year has remained largely unchanged this year, and business risk, which has seen a slight dip.

In the area of "Board matters", the improvement is partly due to the enhanced independent requirements introduced by MAS that put a hard limit of nine years for independent directors. In the area of "Communication with unitholders", we have also seen trusts starting to put up minutes of meetings on their websites.

Keppel DC Reit retained the top ranking for the second edition of GIFT, joined at the top by CapitaLand Commercial Trust which has moved up from number 8 in last year's ranking.

Two other trusts made significant gains to enter the top 5, with Mapletree Commercial Trust moving from 15 to 4 to joint third position with Mapletree Greater China Commercial Trust, which made the biggest leap from number 26. Just half a point separated the top four trusts, making this GIFT ranking very competitive. Meanwhile, Frasers Logistics & Industrial Trust, which is ranked for the first time, enters the ranking at number 5.

The trusts that have made it into the top five this year have done so mainly by putting minutes of their unitholders' meetings on their website, having a policy requiring non-executive directors to hold some units at all times during his or her board tenure, and improving board governance and disclosures.

Other trusts such as AIMS AMP Capital Industrial Trust and ESR Reit (formerly Cambridge Reit) have continued to fare well this year.

Some trusts have been overtaken in the rankings even though they have largely maintained their scores compared to last year. This was the result of greater effort on the part of some other trusts to improve their disclosure and governance practices. Other trusts have simply become better.

Certain related Reits moved up in tandem, suggesting that a collective effort was put in to improve disclosure and governance.

A number of those ranked low on GIFT last year have been facing challenges. First Ship Lease Trust's syndicated loan facility went into default. Its trustee-manager was then sold, a new sponsor was appointed and the chairmanship of the trust was handed over to the new controlling unitholder while the trust sold some of its assets to pare debt. The trust delayed its AGM and the auditors highlighted the existence of material uncertainty related to going concern as an emphasis of matter in its accounts. Eventually, the trust secured commitments to refinance its overdue syndicated loans.

RHT Health Trust also received an emphasis of matter for a material uncertainty related to going concern. Hutchison Port Holdings Trust and Accordia Golf Trust both suffered from falling distribution per unit, with their respective unit price falling by more than a third and by about 15 per cent. LMIRT has fallen by a third in price too as the quality of its malls came under question, coupled with concerns about the deteriorating credit quality of its sponsor.

However, we do not assert that GIFT will necessarily predict the financial performance of a trust especially over the short term, or that a highly-ranked trust will continue to be well governed.

This year, we also separately disclose the governance and business risk scores. The top five ranked trusts were also ranked in the top 10 in both areas.

Governance Index for Trusts 2018

RANK	REIT/BT	GOVERNANCE SCORE	BUSINESS RISK SCORE	GIFT 2018
1	CapitaLand Commercial Trust	61	18	79
1	Keppel DC Reit	60.5	18.5	79
3	Mapletree Commercial Trust	58	20.5	78.5
3	Mapletree Greater China Commercial Trust	61.5	17	78.5
5	Frasers Logistics & Industrial Trust	57.5	20	77.5
6	ESR Reit	62	15	77
7	AIMS AMP Capital Industrial Reit	61.5	14.5	76
8	Ascendas Reit	60	15.5	75.5
8	Manulife US Reit	57	18.5	75.5
10	CapitaLand Mall Trust	57.5	17.5	75
11	Frasers Centrepoint Trust	60	14	74
12	Mapletree Industrial Trust	51	22.5	73.5
12	Soilbuild Business Space Reit	64	9.5	73.5
14	IReit Global	54	18.5	72.5
15	Ascott Residence Trust	56	16	72
16	Frasers Hospitality Trust	55.5	15.5	71
17	Frasers Commercial Trust	53	17	70
18	Ascendas India Trust	54	15.5	69.5
18	Mapletree Logistics Trust	54.5	15	69.5
20	Keppel Reit	55	14	69
20	Parkway Life Reit	53	16	69
22	First Reit	54	14.5	68.5
23	CapitaLand Retail China Trust	52	16	68
24	SPH Reit	55	12	67
25	Ascendas Hospitality Trust	50.5	15.5	66
25	Keppel Infrastructure Trust	49	17	66
25	Suntec Reit	53	13	66
28	BHG Retail Reit	55.5	8.5	64
29	Far East Hospitality Trust	52.5	11	63.5
30	Starhill Global Reit	46	17	63
31	OUE Hospitality Trust	43	19	62
32	CDL Hospitality Trusts	50.5	10.5	61
33	Asian Pay Television Trust	47	12	59
34	Cache Logistics Trust	49	9	58
34	Dasin Retail Trust	44.5	13.5	58
34	EC World Reit	48	10	58
37	Viva Industrial Trust	55.5	2	57.5
38	Accordia Golf Trust	44	8	52
39	OUE Commercial Reit	41.5	9	50.5
40	Sabana Reit	48	0	48
41	Hutchison Port Holdings Trust	38.5	7	45.5
42	Lippo Malls Indonesia Retail Trust	48.5	-3.5	45
43	RHT Health Trust	33.5	11	44.5
44	First Ship Lease Trust	35	5	40

Note: The main Governance score and Business risk score add up to 80 and 20 points respectively. In the two columns above, the scores include merit and demerit points. That is why two trusts scored more than 20 points and a trust received negative points in the business risk section.

Source: Mak Yuen Teen, Chew Yi Hong

Watchlist issues

While the standard of governance and disclosure of trusts is generally good and improving, there are certain matters that, if left unchecked, may cause governance, business risk or performance issues for trusts going forward.

One possible issue is the lack of financial details when there is a change of control in the manager or sponsor, which has occurred for several trusts. The risk is that if a high price is paid, unitholders may ultimately suffer as the manager/trustee-manager is faced with significant pressure to deliver returns to the new owners. Ultimately, it may lead to unitholders paying higher fees to the manager/trustee-manager.

The manager, especially one that has undergone a change in ownership, may change the mandate of the trust. Most, if not all, trust deeds allow the manager to expand its investment mandate with 30 days' notice given to "inform" unitholders that the mandate has been expanded. Under the trust deed, no approval by unitholders is required.

There have been several examples of the expansion of a trust's mandate, with or without a change in ownership. A Singapore-focused industrial Reit has expanded to Australia while an Australian-focused industrial Reit expanded to Europe. The usual reason given is the lack of investment opportunities in its original mandate.

One trust hastily announced a proposed acquisition under the new mandate on the 28th day of the 30 days' "notice period". One other trust went even further to announce a proposed acquisition together with the announcement of an enlarged mandate.

The new mandate may significantly alter the risk profile of a trust. Unitholders have to evaluate if the manager/trustee-manager has the expertise and the network to make good on the diversification and consider if the governance is in place to prevent over-aggressive acquisitions especially as most managers/trust-managers are compensated based on assets-under-management.

Another possible issue is the added exposure of foreign assets earning income denominated in foreign currency, which will introduce uncertainty and risks to the unitholders' expected income in the form of distributions. However, most Reits have a certain level of natural hedging (i.e. foreign currency denominated loans for its foreign assets). Hedging the income will reduce the foreign currency risks and provide a certain level of certainty to the short-term cash flow. Some Reits have, as a policy, chosen to be exposed to currency mis-match, ie. borrowings in Singapore dollars to invest in foreign assets earning income denominated in foreign currency.

Some new Reits and business trusts have emerged in the market that have the sponsor/controlling unitholder/vendor waive their rights to receive distributions for a certain period of time. This then allows the units to be sold/IPO-ed with a certain level of yield to attract investors. In one particular trust, it was disclosed in the annual report that as much as 55 per cent of the units on issue have waived their right to receive distributions. In effect, the actual distribution per unit (DPU) has been artificially boosted to twice its "sustainable" level if all units are ranked the same and receive distributions. These Reits are trading at artificially high yields and investors who do not read the fine print may not be aware of it.

As stipulated in the trust deed, the fees of managers and trustee-managers could be paid in cash or in units at their discretion. A Reit increased its DPU despite carrying out a major asset enhancement initiative at one of its key assets. This was achieved partly by electing to receive its fees in units instead of cash so that the Reit could keep up its trend of increasing DPU over the years/quarters. Ultimately, there is no free lunch. The hidden cost to unitholders is the dilution of their unitholdings.

The full report and the GIFT scorecard are available for download at www.governanceforstakeholders.com.

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