

Tweaks to the scoring for governance index prepare trusts for more volatile weather

Rankings in GIFT 2020 place less focus on pure disclosure and meeting standards, and more on substance. **BY MAK YUEN TEEN AND CHEW YI HONG**

In our article "A refined 'GIFT' for a changed world" (*The Business Times*, July 21), we discussed many of the refinements and changes we intended to make to the Governance Index For Trusts (GIFT) 2020.

Given that the sector has matured and its risk profile is changing, it is timely to raise the bar, with less focus on pure disclosures and meeting minimum standards, and more on substance. It is important that the good work that the Monetary Authority of Singapore (MAS) and the Singapore Exchange (SGX) have done in building up the sector is not undermined by cases such as Eagle Hospitality Trust (EHT).

Who's included

For this fourth edition of GIFT, 45 real estate investment trusts (Reits) and business trusts (BTs) listed on SGX were assessed, compared to 46 last year.

Five trusts were excluded – RHT Health Trust because it is a cash trust; EHT because it is suspended with its annual report issued only after the cut-off date; and three newly-listed trusts which have not yet published their annual report by the cut-off date (Elite Commercial Trust, Lendlease Global Commercial Trust and United Hampshire US Reit).

Three trusts were taken over and merged with other trusts and no longer listed on the SGX. Two trusts are new in the 2020 edition – Prime US Reit and ARA US Hospitality Trust.

More up-to-date assessment

This year, we used annual reports published between October 2019 and August 2020. The cut-off date for the data collection was extended to Aug 31, 2020. However, the AGMs covered were held between October 2019 and September 2020.

We used the latest available quarterly/half-yearly results to assess business risks to make GIFT even more timely. All but one of the trusts were assessed based on the June 2020 results or operational/financial updates. The only exception was a Reit that published its third-quarter results that ended on May 31, 2020.

Participation in the self-assessment, which we started in 2018, reached a high of 78 per cent this year. We appreciate the interest of trusts in GIFT and look forward to their continuing engagement on this initiative.

Overall dip in scores

The main governance section now carries 75 points, instead of 80 points, while the main business-risk section increases from 20 points to 25 points.

Given the changes, the scores this year are not directly comparable to last year's. These changes have contributed to an overall drop in the scores and some major shifts in rankings. But our assessment is that while there have been areas of improvement, overall, standards have stagnated, regressed or not met expectations.

The mean combined governance and business-risk score slipped to 64.3 in GIFT 2020, from 68 last year. The median this year is 66, down from 68.25 last year.

The top-ranked trusts in GIFT 2020 are Netlink NBN Trust, Keppel DC Reit, AIMS APAC Reit, Capitaland Commercial Trust, Manulife US Reit and Mapletree North Asia Commercial Trust. (The latter three are in joint fourth place.)

The highest score is 90 obtained by Netlink NBN Trust, which was also ranked top last year when it debuted in GIFT. It is also the only trust in the top eight not to slip in its



The fourth edition of GIFT assesses 45 real estate investment trusts and business trusts listed on the SGX. BT PHOTO: YEN MENG JIIN

score. This could be partly attributed to its internalised trustee-manager model, which leads to a better alignment of interests with unitholders, setting it apart from other trusts.

At the other end, the six lowest-ranked trusts are Asian Pay Television Trust, First Reit (joint fifth last), Lippo Malls Indonesia Retail Trust, Accordia Golf Trust, Dasin Retail Trust and Hutchison Port Holdings Trust. The last-named, with the lowest score of 39, was Hutchison Port Holdings Trust; it was the lowest-ranked last year as well.

The two new entrants, Prime US Reit and ARA US Hospitality Trust, debut at joint 10th and joint 24th respectively.

The following are some of the key highlights for GIFT 2020:

A few areas of across-the-board improvement

This year, all but two trusts posted their minutes, but this improvement was mostly due to Covid-19 measures introduced by the Accounting and Corporate Regulatory Authority (ACRA), MAS and SGX. The two that did not post detailed minutes held their meetings prior to the pandemic. We hope that trusts will continue to post detailed minutes after the Covid-19 measures are no longer in place.

Most trusts held online AGMs and EGMs due to Covid-19; five held face-to-face meetings before Covid-19. ACRA, MAS and SGX issued guidance, which strongly encouraged issuers to provide at least 21 calendar days' notice. In line with this, more trusts provided longer notice periods of at least 21 days for meetings with no special resolution and at least 28 days for meetings with special resolution.

All except one trust disclosed the actual remuneration of each individual non-executive director (NED) on a named basis, although one only did so after it was queried by SGX.

More trusts disclosed the performance measures used to determine the remuneration of the chief executive. Often, the disclosures were more detailed, with more trusts stating that they use a unitholder-centric metric, such as total unitholder returns as the key performance indicator. Two-thirds of the trusts have put in place a remuneration framework that includes a long-term component.

In the business-risk section, Reits promptly disclosed their interest coverage ratio (ICR) as required by MAS, with all but one reporting an ICR of above 2.5 times.

On average, Reits and BTs are still well-financed. Approximately half the trusts still have healthy weighted average debt maturity of more than three years, largely comparable to 2019 (49 per cent vs 52 per cent); more than three quarters have less than a quarter of debt maturing in the next 12 months (78 per cent in both years).

Areas of stagnation, regression and under-performance

It is disappointing that the number of trusts that allow unitholders to endorse directors at the AGM remains low, with only six doing so – Keppel DC Reit, Keppel Infrastructure Trust, Keppel Reit, Netlink NBN Trust, Parkway Life Reit and Starhill Global Reit.

Given the fact that all directors of Reit managers and trustee-managers are appointed by the shareholders of the managers, and not the unitholders of the trust, it is difficult for independent directors (IDs) to be perceived to be truly independent.

The issue of independence of IDs has arisen in several cases in the past year and becomes particularly contentious in merger and privatisation situations.

We believe that regulators should consider requiring trusts to seek such endorsement from unitholders, and the controlling unitholders, sponsor and their associates should abstain from the vote.

The regulations for Reits and BTs specify a list of criteria for determining independence, but allow the board to determine that a director is still independent even if those criteria apply. It is not uncommon for trusts to use this flexibility given by the regulations.

We have also observed some IDs making lateral moves to related trusts once they hit the nine-year tenure on the board of a Reit.

We are stricter this year in assessing independence, since unitholders are unable to appoint or remove directors and are rarely given the opportunity to endorse them.

For GIFT 2020, we re-designated 14 directors serving on 11 trusts from independent to non-independent, usually for consulting or advisory work, or tenure exceeding nine years.

In addition, demerit points were imposed on IDs in 23 trusts due to other factors such as other relationships with the sponsor or controlling unitholder and serving on three or more listed boards while having a full-time job.

On the tenure of IDs, the Reit and BT sectors diverge.

When an ID reaches a tenure of nine years in a Reit, he or she is replaced. In business trusts, when IDs reach nine years, the business trusts often justify that the long-tenured directors are still independent and retain them.

This is because the regulations for Reits have been updated with a hard limit for tenure, while the regulations for BTs have not. It may be timely to update the BT regulations to align with those for Reits.

There are also questions relating to whether IDs of some trusts are selected for their competencies. Trusts should better explain how they see such directors contributing to board effectiveness.

The percentage of trusts with a nominating committee (NC) and remuneration committee (RC) – or a combined NRC – has fallen. This was partly due to the dissolution of two NRCs following the merger of a property group with another, and the delisting of another three trusts with NRCs.

Only 12 trusts earned the maximum points for continuing with quarterly reporting, either by the trusts explicitly stating so or by the trust carrying on with its quarterly reporting with no explicit announcements made.

Out of the remaining 33 trusts that have stopped quarterly reporting, 11 have given assurance to unitholders that they will be providing an interim quarterly update for the first and third quarters. The remaining 22 trusts gave a boilerplate statement that they will "continue to keep unitholders updated on material developments, as and when appropriate, in accordance with requirements of the Listing Rules".

The removal of quarterly reporting has also affected how frequently trusts make distributions to unitholders. At least nine trusts have stated that they will change from a quarterly to a half-yearly distribution, following the cessation of quarterly reporting.

Twenty trusts were already making half-yearly distributions before the change in quarterly reporting.

Ten trusts continued to disclose quarterly results and make quarterly distributions, although two of them noted that they continue to do so as they are in the middle of a merger and will review the situation after the merger.

Five trusts appeared to have made the decision to stop quarterly reporting but to continue with quarterly distributions.

While the disclosure of NED remuneration has improved, we see no progress in the disclosure of remuneration of executive directors, CEOs and key management personnel. Only three trusts disclosed the exact remuneration of the CEO – Far East Hospitality, Hutchinson Port and Netlink NBN Trust.

Disappointingly, a third of the managers collected higher fees while delivering lower distribution per unit (DPU) for unitholders. Another 40 per cent raised their fees more quickly than the rise in DPU, or lowered their fees more slowly than DPU decreased.

A third of the trusts held their meetings on days we consider as peak days (last five business days of the month) in this year's study, compared to just 28 per cent last year.

Business risks

Average leverage has crept up slightly from 34.9 per cent to 35.7 per cent compared to last year, although Reits have greater headroom with MAS allowing an increase in the aggregate leverage limit to 50 per cent, which became effective in April 2020.

Trusts also have greater currency risks on average, with a lower proportion opting to fix at least 70 per cent of their interest rates for their borrowings. This could be partly due to higher exposure to foreign assets in general for the trusts.

While Reits have promptly published their ICRs, only three BTs did so because it is not mandatory for them. Logically, BTs should also disclose their debt-servicing ability, as measured by ICR, to unitholders.

The weighted average lease expiry (or WALE) is one area in which trusts have performed less well. Last year, approximately two-fifths of the trusts increased the WALE or have a WALE by gross rental income greater than five years. This year, it dropped to just under a third.

The percentage of trusts maintaining their WALE also fell from 30 per cent to 18 per cent. We believe that the assessment using WALE by gross rental income (GRI) partly contributed to the drop, but this also reflects the challenges and uncertainty brought about by the pandemic.

There is greater use of perpetual securities as a source of funding – 31 per cent of the trusts used hybrid securities this year compared to 26 per cent last year.

Our report this year also includes an overall review of the sector which trusts and investors may be interested in. This review highlights some specific issues, often applicable only to a few trusts, but which may nevertheless impact the sector over time.

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GIFT is supported by the Singapore Exchange, MoneySense, the national financial education programme, provides a link to GIFT to help investors assess if they are comfortable with the corporate governance of Reits.

The full GIFT report and the scoring guidelines are available at www.governanceforstakeholders.com