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# The rise – and huge potential – of China Reits

Local sponsors in China and institutional investors could seek new opportunities and synergies when riding on the burgeoning C-Reit market.

**By Sing Tien Foo and Sonny Tan Hock Sun**

The first batch of China Reits, listed in 2021 with an aggregate value of 31.2 trillion yuan (about S$6 trillion), hold infrastructure assets ranging from toll roads and waste treatment plants to logistics and industrial parks. Since then, the C-Reit market has grown exponentially, raising a total capital of more than 75 billion yuan, with the listing of 24 infrastructure and rental housing Reits as of December 2022. PHOTO: BLOOMBERG

THE first batch of nine China real estate investment trusts (C-Reits) made their public debut on the Shanghai and Shengzhen bourses in June 2021. These onshore C-Reits, with an aggregate value of 31.2 trillion yuan (about S$6 trillion), hold infrastructure assets ranging from toll roads and waste treatment plants to logistics and industrial parks.

Since 2021, the C-Reit market has grown exponentially, raising a total capital of more than 75 billion yuan, or more than S$15 billion, with the listing of 24 infrastructure and rental housing Reits as of December 2022.

In August 2022, C-Reits expanded their asset classes to include affordable rental housing with three public rental housing Reits, which raised a total of 3.8 billion yuan (or S$740 million). These new C-Reits help partially cushion the affordable rental housing segment against the impact of the debt crisis that has swamped property developers in China from 2020.

The growth of C-Reits has been spectacular over the last 18 months. Given the sheer amount of resources and infrastructure assets available in the country, the potential for further growth is enormous.

### The emergence of C-Reit markets

China started exploring real estate securitisation as early as 2001. Two papers linked to China's exploratory phase of real estate securitisation markets were issued. First, the National Development and Reform Commission (NDRC), formerly the National Development Planning Commission, issued a public consultation paper on "Interim Measures of Investment Fund Management" which was shelved.

Second, the People's Bank of China, China's central bank, issued the "Trust Investment Companies Management Guidelines" in the same year. It outlined business activities permitted for trust companies and included provisions safeguarding the interests of trust beneficiaries and investors.

Besides the regulatory efforts, two public market issuance activities helped lay the ground for C-Reit developments. First, Chinese firms started to use offshore Reits to tap into foreign capital markets for new funding sources. Yuexiu Reit (previously known as GZI Reit) was the first offshore Reit listed on the Hong Kong Stock Exchange in 2005. Guangzhou Investment (GZI), a company linked to the Guangzhou state government, raised a total of US$204 million by divesting four commercial properties in the Pearl Delta River region.

Following the successful listing of Yuexiu Reit, several offshore C-Reits were also listed in Singapore. CapitaLand Investment, Singapore's largest real estate group, set up and listed the first offshore C-Reit – the CapitaLand China Trust (formerly known as CapitaLand Retail China Reit or CLCT), on the Singapore Exchange (SGX) in December 2006. It uses an offshore special purpose vehicle (SPV) to facilitate the transfer of shareholdings from its asset-holding companies that directly own retail malls in China. Foreign investors set up wholly foreign-owned entities (WFOEs) or equity joint ventures (EJVs) as their onshore asset-holding companies.

Four other China pure play Reits listed on Singapore's bourse are BHG Retail Reit, Dasin Retail Trust, EC World Reit, and Sasseur Reit. Other Singapore-listed cross-border Reits with significant Chinese real estate assets in their portfolios include Mapletree Logistics Trust, Mapletree Pan-Asia Commercial Trust, CapitaLand Ascott Trust, OUE Commercial Trust, and Starhill Global Reit.

The second key development that contributed to the subsequent establishment of C-Reits was the test-bedding of the "quasi-Reit" in China. In 2015, China Vanke Co teamed up with Penghua Fund Management to launch the first public "quasi-Reit" (or "pre-Reit") with properties in a business park in Qianhai, Shenzhen. The China Securities Regulatory Commission (CSRC) approved the Penghua-Vanke quasi-Reit, which used asset-backed securities (ABS) to create the off-balance-sheet financing structure. It issued hybrid fixed-rate finite-term debt securities and listed them on the Shenzhen Stock Exchange.

**Singapore's cross-border Reits, with exposure to Chinese assets, are not likely to be cannibalised by the growth of the onshore C-Reit market. When Chinese investors become more familiar with C-Reits, they may seek to diversify investments into Reits backed by other asset classes.**

The experiences from offshore Reits and quasi-Reits were valuable, leading to the joint publication of the infrastructure Reit guidelines by NDRC and CSRC in April 2020.

### Infrastructure focus assets

The NDRC and CSRC are the key agencies instrumental in establishing and regulating C-Reits. The NDRC oversees macro-prudential controls, policies, and assessments of project investments, whereas the CSRC is the regulator supervising and monitoring stock market issuance activities.

When evaluating the feasibility of C-Reits, the two authorities demonstrated clear strategic motivations and considerations beyond merely introducing new investment products. They have judiciously leveraged financial innovations to provide new funding sources for infrastructure developments in China.

Since 2016, infrastructure projects funded primarily through the private-public partnership (PPP) have expanded rapidly to support urbanisation in China. However, the capital-intensive nature of infrastructure projects imposes significant financial strains and burdens on private investors, who find it hard to exit and recycle their capital.

Integrating PPP projects with the securitisation market is believed to be a win-win arrangement that can bring incremental economic outcomes. On the one hand, PPP projects supply quality infrastructure assets with stable income streams as underlying assets for C-Reits. On the other hand, C-Reits offer an exit strategy for PPP investors. The public markets could improve the efficiency and transparency of the price discovery mechanism of the infrastructure market. Operations and service quality in infrastructure projects could also be raised when performance-driven professional managers are appointed to run infrastructure projects.

The alignment of goals between securitisation and PPP has paved the way for shaping Reits with Chinese characteristics. In July 2020, NRDC published an important document, "Notice on Applications of Infrastructure Reit Pilot Programmes" identifying the type of infrastructure projects that can be securitised for C-Reits. In August 2020, CSRC issued "Guidelines on Infrastructure Reits" to spell out listing-related matters.

Seven categories of infrastructure projects have been identified:

■ logistics and industrial parks
■ transportation projects, such as toll roads, rail transit lines, seaports, and airports
■ waste management, water recycling, and environmental-related projects
■ utility projects, such as water, electricity, gas, and heating
■ data centres, facilities supporting artificial intelligence, cloud computing, etc
■ 5G networks, internet, broadband and e-commerce
■ smart solutions and systems for transportation, energy, and cities

### Structure for C-Reits

There are two regulatory restrictions in introducing publicly listed equity Reits in China. First, debt securities issued via ABS, as adopted by some quasi-Reits, can only be distributed through private placements, which restrict the issuance's liquidity. Second, mutual funds that issue equity securities cannot directly hold non-listed securities and properties.

The authorities propose the "ABS + Mutual Fund" model to circumvent the restrictions imposed on issuing publicly-traded equity Reits. The model overlays a "mutual fund" layer above the ABS structure commonly used by quasi-Reits. In this way, a mutual fund can acquire all issued ABS securities and indirectly owns beneficial interests in infrastructure assets. It will then issue C-Reit units backed by ABS securities and distribute them through an IPO exercise to institutional and retail investors. The C-Reit units can be freely traded upon listing on a public exchange.

### Impact on offshore C-Reits in Singapore

C-Reits currently focus only on the infrastructure and affordable rental housing sectors. They do not directly compete with Singapore Reits holding China's commercial, logistics, warehousing, and hospitality real estate assets, which we refer to as offshore C-Reits.

Singapore's cross-border Reits, with exposure to Chinese assets, are not likely to be cannibalised by the growth of the onshore C-Reit market. When Chinese investors become more familiar with C-Reits, they may seek to diversify investments into Reits backed by other asset classes. This will increase demand for offshore C-Reits that hold different asset classes not currently permitted for onshore C-Reits.

Local sponsors in China and institutional investors could seek new opportunities and synergies when riding on the burgeoning C-Reit market. They could work with foreign Reit sponsors and investors to broaden fund and asset management professionals and expertise in China. Foreign investors could bring new capital sources to support the growth of infrastructure developments in China.

Two factors may initially work against the onshore C-Reits market in its rapid ascent to the advanced Reit markets. First, strong demand for C-Reits by Chinese retail investors with huge savings will drive up unit prices. Second, some Chinese retail investors may wrongly perceive listed Reits as typical equity stocks in seeking quick capital gains. These factors will arbitrarily drive up unit prices and compress yields to an unattractive level for international investors. Chinese authorities need to pre-empt any irregularities until the market can sort itself out.

No one should doubt that the C-Reit market will be a major player in the global Reit industry, especially when it extends beyond the initial focus on infrastructural assets. China's property market has been in persistent doldrums following the delinquency of overleveraged developers, such as China Evergrande Group and Sunac China Holdings, in 2020.

If asset classes were extended to private residential property assets, the C-Reit market could also potentially provide liquidity much needed by ailing private residential developers in China.

Based on UBS's optimistic scenario analysis, if China could just securitise 5 per cent of its infrastructure assets valued at US$60 trillion, the C-Reit market could reach US$3 trillion in market capitalisation by 2030. The C-Reit market would have then eclipsed the US Reit market,which has a current market capitalisation of US$1.4 trillion (source: National Association of Reits or Nareit) to become the world's biggest Reit market.

Its scale economics reduces capitalisation rates and removes inefficiency in the real estate market. The benefits could also spill over to other regional Reit markets; thus, this scenario should not be deemed a "zero-sum" game. However, it may need to smoothen some rough edges before attaining the same level as the advanced Reit markets.

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