

Guest of Honour speech by Tan Boon Gin, CEO of Singapore Exchange Regulation (SGX RegCo), at the REIT Association of Singapore Annual Conference 2024

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Introduction

Distinguished guests, members of the Reit Association of Singapore, and fellow colleagues. Thank you for having me yet again. In all my past REITAS engagements, I have always tried to keep the topic current. One year, I spoke about Reits becoming less Singapore centric and looking more toward overseas assets. In another year, I talked about higher interest rates and their impact on Reits' leverage levels. This year will be no different. I intend to touch on another hot button topic: namely internalisation.

The shift towards internalisation

1. Indeed, not to talk about internalisation would be to ignore the elephant in the room. I know my audience today includes many external Reit managers who are watching this development very closely. My remarks will approach the subject with you in mind.
2. Traditionally, Singapore-listed Reits, or S-Reits, have been managed by external managers owned by sponsors. Sponsors like this model because they can recycle capital, retain control over the properties, and earn recurring income through management fees. Unitholders are willing to accept this model because, in return, sponsors can provide a pipeline of properties for the Reit to acquire and help secure better financing terms. And indeed, many of our Reits have grown tremendously over the past 20 years because of our sponsors' efforts.
3. Nevertheless, like all things, the external manager model isn't perfect. It has given rise to a number of questions including:
 - alignment of interest of the unitholders and managers in terms of the fees paid, whether they be in units or cash,
 - how fees should be structured: namely, whether fees should be based on distribution per unit or net property income, and
 - concern that managers may be entering into M&A deals to benefit their sponsors or simply to earn more fees.
4. These issues have been around for a while. The option of internalisation has also been there since Day One. So why are we only seeing internalisation efforts now? I believe 3 factors account for this trend:
 5. The first is the recent emphasis on enhancing shareholder value or in the case of Reits, unitholder value, that has been gaining momentum particularly in this region. We ourselves have recognised this demand, which is why our recent regulatory emphasis has been on what we call value focus initiatives to facilitate enhancing shareholder value. Unitholders want to see more value from their sponsors and managers, in return for the fees they are paying.

6. Second is the rise in interest rates prior to the most recent months. Higher rates as you well know, make financing conditions difficult. Unitholders become more sensitive to costs. They then start to question whether external managers and sponsors are adding enough value to justify their costs.

7. Unitholders are more ready to remove external managers if they feel the value added does not outweigh the management fees. Indeed, internalisation allows unitholders to have greater control over the manager in addition to potentially saving on fees. This shift reflects a broader desire for more direct oversight and accountability which I will elaborate on later.

8. Third, REITs are much bigger now. As I mentioned earlier, the conventional thinking in the past was that external managers and sponsors add a lot of value by providing a pipeline of properties and securing better financing terms. Today, what I am hearing from unitholders of big Reits is: "Our Reit is now so big. Maybe we no longer need to depend on the sponsor for properties and can secure good financing terms on our own."

Internalisation as one form of market discipline

9. So, what are the implications for our externally managed Reits? Again, I can see 3 trends that are shaping the situation.

10. First, in general as a stock market matures, investors develop stronger views, are more willing to voice these views and put them to a vote. This trend is unlikely to go away. Indeed, this is the level of market discipline every mature market needs so we as regulators, very much want to encourage this. We believe more active investors and effective market discipline will encourage our Reits to improve their operational performance and returns to unitholders.

11. In the same way that we have seen shareholders of listed companies requisition for meetings to put through the changes that they want, Reit unitholders may see the internalisation process as an opportunity to express their views and hold external manager accountable. Simply put, internalisation is but one form of market discipline for unitholders to keep Reit managers on their toes and ensure they create value.

12. Second, unlike companies, it is the sponsors who appoint all the directors to the boards of external Reit managers. I understand for a small number of Reits, the directors of their REIT managers are put up for confirmation by the unitholders. Some Reits like Parkway Life, Keppel DC, and Starhill Global subject their REIT manager directors to unitholders' endorsement. But for the others, the fact that unitholders have no control over the directors of the external Reit managers may have led to unintended consequences. It may be that when unitholders want change, they feel they have little or no say over the board of the REIT manager. This may perhaps have led them to choose the nuclear option of removing the REIT manager altogether. By this I mean that when unitholders are unhappy, they are short of intermediate options and have no choice but to push the red button. In the case of a REIT, it means unitholders may turn to internalisation because there is no other way available to them to express their displeasure.

13. Third, we as regulators want to encourage and actively enable market discipline. Earlier I drew a parallel between internalization by unitholders, and shareholders of a company requisitioning a meeting to remove the board of directors. This is market discipline at work, which is why we proposed in April to

make it easier for shareholders and unitholders to call for general meetings to bring about the changes they feel are important.

14. People tend to think of market discipline as a negative thing, in terms of investors punishing the share price of a company because they disagree with what the company is doing. It is important to remember that market discipline cuts both ways. If investors are happy with what the Reit is doing, then the market should reward the Reit by increasing the share price. We as regulators also want to facilitate this upside of market discipline. That is why we have fine-tuned our surveillance system to reduce our trading queries when there is a movement in share price. This will allow Reits that enhance unitholder value to fully reap the benefits of their efforts and to fully enjoy the upside of market discipline through an unfettered increase in share price.

Internalisation vs External Managers: What's SGX RegCo's position?

15. Where then do we at SGX RegCo stand on internalisation versus external management?

16. Our view is that whether a Reit should internalise or have an external manager, is a decision for unitholders. As a regulator, our guiding principle is that once unitholders have decided one way or the other, we will support the process. If the requisite number of unitholders have decided in favour of internalisation, then let us get on with it. We will not allow internalisation to be blocked using backdoor methods.

17. Now, internalisation is a new development here, and we have yet to see the process happen end to end. I must admit it has been a learning journey for us as regulators as well and we are always open to hearing how we can make the process smoother and faster. We have already learnt that trust deeds may not have been written with internalisation in mind. One suggestion has been to have only one voting exercise whereby unitholders can vote at a single EGM on all the changes that need to be made at one go. Another idea is to ensure unitholders are well-informed of what the entire internalisation exercise may entail before they vote. While we hear this and are committed to improving the process, this is not something we can do alone. We will need to work with our fellow regulators to improve the process.

Conclusion

18. What then should external managers do in the face of internalisation becoming a possibility in the S-Reit sector? It follows that if internalisation is one form of market discipline, then perhaps keeping unitholders happy would be the one way to respond. So, here's what I think external managers can consider if they do want their unitholders to be happy:

19. First, as I mentioned at the start of my speech, there are questions about fee structure and whether there is alignment of interest with unitholders. External managers may wish to consider these issues and how to communicate clearly to unitholders their thinking and how they are ensuring that their interests are aligned.

20. Second, sponsors may also wish to consider giving unitholders some intermediate options to express their views. Unitholder engagement is a good start. Indeed, I am heartened by the efforts of some Reit managers that are facing macroeconomic headwinds to engage their unitholders. Another way may be to give shareholders a say in the appointment of directors. We already do have Reits for example, that give unitholders a confirmatory vote on the appointment of directors to the Reit manager.

21. Finally, and most importantly, is for sponsors to signal very clearly their commitment to create value for unitholders. One lesson we can learn from this is that sponsors should avoid having Reits with overlapping mandates or anything at all that may lead unitholders to question their commitment to the Reit or to one Reit over another. In this regard, I am again heartened to see recent articles in the local media highlighting how our Reits have been active in their portfolio management activities to pursue growth.

22. On that note, thank you for your attention. I wish you a fruitful day of discussions and learning.

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