

The Current Situation and Prospect of Private Equity Real Estate and Reits in Mainland China

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Abstract: Mainland China's real estate financial market is vast. So, Mainland China's REITs and Private Equity Real Estate are greatly potential. In the current situation, Mainland China's foreign and domestic Private Equity Real are both active. In addition, Mainland China has launched the infrastructure REITs proposal, and there are several successful cases of private REITs. In the future, the scale of Private Equity Real Estate in Mainland China will be further expanded. Mainland China's REITs are also likely to be implemented in the field of commercial real estate. The combination of Private Equity Real Estate and REITs will become an important model of Mainland China's real estate financial market in the future.

1. Introduction

On April 24, 2020, the China Securities Regulatory Commission and the National Development and Reform Commission issued the proposal on promoting the pilot work of real estate investment trust funds in the field of infrastructure. This is conducive to deepening the structural reform of the financial supply side, strengthening the ability of the capital market to serve the real economy. And it is useful to further innovate the investment and financing mechanism, effectively invigorate the existing assets, and promote the high-quality development of infrastructure. Mainland China's foreign and domestic Peres are both active. "Private Equity Real Estate + REITs" will become the mainstream mode of Mainland China's real estate financial market in the future. In the future, the real estate market in Mainland China will depend on each other by developers, investors, service providers and operators, which will bring about the improvement of efficiency and the value-added of property holdings through professional division of labor. The real estate market will use asset securitization to achieve financing and rapid turnover of funds.

2. The Current Situation of Reits in Mainland China

At present, REITs in Mainland China is only used in infrastructure, but not in commercial real estate. However, commercial real estate can play a greater value of REITs. Whether Mainland China can implement REITs depends on policy, tax and other factors. Mainland China's commercial real estate REITs has a low maturity, but it has gradually become a hot field, which has attracted the attention of experts, scholars and the public. It can be predicted that commercial real estate REITs in Mainland China will first rise in Beijing, Shanghai, Shenzhen and other developed cities.

The income growth rate of commercial real estate is higher than that of residential real estate. In addition to earnings per share, commercial real estate REITs also have rental dividend income. The Chinese government strictly restricts the development and purchase of residential real estate to stimulate the demand of real estate enterprises for commercial real estate investment. Therefore, REITs, as a new financing channel in the real estate market, can raise a lot of funds for unlisted real estate companies. The Chinese government has issued a proposal to encourage banks to issue infrastructure REITs, which shows a trend of implementing REITs on a large scale.

At the background of higher loan interest rate, tightening real estate credit policy, shrinking scale of equity financing and bond financing, REITs as a new way of real estate financing has become increasingly important. REITs can connect the real estate market and capital market, help

developers to obtain funds, accelerate capital accumulation, and improve capital and land use efficiency. In addition, it helps the real estate industry to pay more attention to the direction of management transformation and upgrading.

After nearly 16 years of development, real estate asset securitization has begun to take shape, but there is no standard REITs in the market. At present, the main bottlenecks of REITs in Mainland China are imperfect laws and regulations, lack of tax policy, unclear regulatory body, high market access threshold and low-income coverage ratio. Due to the immature legal and market conditions of REITs, there is a huge market demand. Many similar REITs like products have been issued in Mainland China, such as Suning Commerce Group. According to whether the underlying property is held or not, REITs can be divided into equity REITs and mortgage REITs.

REITs have the characteristics of stocks, which effectively solve the problem of poor liquidity of real estate, and at the same time attracts investors who hold a small amount of funds to invest in real estate, so as to raise funds through more channels and achieve diversified financing methods. Nowadays, the financing methods of Mainland China's real estate development companies are diversified, including banks, Private Equity Real Estate, REITs and listed companies. Compared with index funds, REITs have higher risk and higher return. Whether the business condition of commercial real estate is good or not, and whether it can charge the corresponding amount of rent have become the risk factors. At the same time, the rate of return of REITs is also high. The average annual rate of return of American REITs can reach more than 12%. However, compared with investment in stocks, REITs have less risk and are suitable for long-term investment. Because the income of rent is relatively stable, not as volatile as the stock market. REITs can take the form of both rent and sale, which can not only avoid the loss of high-quality appearance caused by sale, but also quickly return funds through leasing.

Before REITs quit, commercial real estate investment is an investment company with a lot of capital, which has high investment threshold but considerable income. After the implementation of REITs, the subscription threshold is low. REITs have strong liquidity and stable income. It can disperse risk by purchasing different types and regions of REITs.

In 1992, Yuexiu Group listed its Yuexiu Investments with real estate development as its core business in Hong Kong. The main success factors of Yuexiu REITs are as follows. First, Yuexiu Group selects high-quality properties to be listed. The projects are high-quality property assets with stable rent and great potential for rent appreciation. Second, all listed properties are indirectly held by BVI company, which brings tax preference and simple structure for REITs, which is easy to manage. Third, Yuexiu Group selects managers as internal employees, which reduces the conflict of interest between managers and investors. Fourth, Yuexiu Investments began to prepare for REITs listing after the completion of asset restructuring. Yuexiu Investments adjusted the equity structure for the listing of REITs during the restructuring period, with clear property rights and indirectly holding properties through some BVI companies, which saved time for the listing preparation.

Suning Commerce Group with Citic Securities Company and Mainland China AMC Capital Management have issued private REITs. At present, the domestic REITs are not mature. Although Citic Securities Company Limited has officially tested REITs, it still lags far behind the international standardized REITs in terms of investment threshold and participation. Moreover, this REITs is still a private REITs only open to institutional investors, and the future public REITs needs further innovation.

3. The Current Situation of Private Equity Real Estate in Mainland China

The real estate private equity fund is similar to the traditional Pre-IPO private equity fund. Most of the existing real estate private equity funds still have a lot of “trust” characteristics. The four processes of real estate private fund are raising, investing, managing and withdrawing. First, real estate companies raise funds. As the Chinese government controls the price of real estate, it becomes more difficult for real estate companies to get loans from banks.

So, some real estate companies raise funds through private institutions. Then the investment mechanism is established between the investment institution and the real estate company, and the

core investment terms are signed. Then it is to establish the organization and management mechanism, formulate the organization mode, decision-making and distribution mechanism. Finally, exit through listing or merger. In China, foreign private real estate funds, such as Blackstone and Warburg Pincus, are active in China's real estate market. Mainland China's real estate private placement fund is also well developed. In 2020, Hony Capital which was the first Chinese mainland's real estate fund management institution entered the ranking of PRIVATE EQUITY REAL ESTATE. In addition, Everbright Investments, Fosun Investment and other real estate private fund companies also have many projects.

Everbright Investments is a private real estate fund company focusing on the Chinese market. Everbright Investments is an Asian company of Lehman Brothers real estate fund. Due to the 2008 financial crisis, the collapse of Lehman Brothers, its business in Mainland China was acquired by Everbright Holdings, renamed Everbright Investments. The investment strategy of Everbright's investment is to invest in the Chinese mainland's second tier city with strong demand to support the real estate market. The fund will invest in recognized national housing developers and local market leaders and establish strategic partnership with them. Greenland Group takes real estate development as its main business, and develops large infrastructure, large finance, large consumption and other emerging industries simultaneously. The equity investment fund set up by Greenland mainly invests in the enterprises representing the development direction of the industry, which will be a supplement to the financing channels outside the listing of enterprises. The investment target of Greenland Group's equity investment is generally a certain scale and stable cash flow forming enterprise, with less risk. The exit channels include IPO, sale, merger and acquisition, management buyback and so on.

4. The Combination of Reits and Private Equity Real Estate in Mainland China

In order to reduce the risk, REITs can acquire the real estate private funds when they are not well managed. The establishment of REITs fund management and supervision mechanism is more conducive to its implementation and risk prevention. Private Equity Real Estate's commercial real estate investment and development is to exit after the construction of real estate projects, and its income does not include the rent of commercial real estate. REITs and Private Equity Real Estate can invest in various types of commercial real estate, such as tourism real estate, cultural and creative real estate, shopping center, wholesale market and so on. Tourism real estate is a commercial real estate model of integrating hotel, shopping and catering around famous tourist attractions. Cultural and creative real estate is to establish a theme amusement park and characteristic cultural village with humanistic history as the core. It covers the accommodation, shopping, dining and other consumption of tourists for a period of time, attracts tourists by relying on wonderful content, and returns the capital through tickets and upstream and downstream industries.

To promote the development of Mainland China's REITs, the Chinese government can take various measures. First of all, at present, Mainland China can formulate REITs policies, and there is a lack of talents to operate and manage REITs. The Chinese government can take various measures to attract experienced REITs practitioners. For example, recruiting doctors and researchers who are familiar with REITs. Then, the Chinese government can formulate the corresponding tax preference system for enterprises to implement REITs. In addition, the Chinese government can improve the relevant laws so that REITs can be implemented smoothly without further raising house prices. Then, it is necessary to select high-quality assets, so that the latter can be better operated and managed. Finally, it is necessary to select suitable areas for implementation. Developed cities are more suitable to implement REITs than poor cities. Because there are more types of commercial, residential and cultural real estate in developed cities, and the income is greater. In the future, REITs in Mainland China can develop into long-term rental apartment REITs, pension real estate REITs, and logistics real estate REITs.

Many real estate developers in Mainland China are involved in the financial field, and the more powerful have combined finance and real estate. Gohigh Fund is the first and largest RMB

commercial real estate private equity fund in Mainland China. Gohigh Fund has the following two types of funds. The first is opportunity funds. It improves value through transformation and asset management operation. It gains high profits through fast in and fast out. The second is value-added funds. It acquires potential properties, improves value through transformation, repositioning and operation management, arbitrages in cyclical fluctuations, and exits through asset securitization or block trading. At the same time, Gohigh Fund incubation private REITs, together with asset holders, launched a merger and acquisition fund. Through the optimization of operating cash flow, and ultimately relying on the high rate of return on rent to achieve the withdrawal of public REITs.

CapitaLand group is the market leader of Asian real estate fund management and one of the largest real estate fund managers in Asia. Capitaland manages REITs and private equity. Capitaland has 2 REITs and 12 private funds that have invested in Mainland China business. The total scale of Capitaland's real estate development funds and trusts in Mainland China is more than 10 billion US dollars.

Capitaland's real estate fund operation process for the purchase of equity, rental operation, asset packaging in Mainland China, listed in Singapore REITs. REITs can only absorb mature properties, while incubation and cultivation of high-quality investment properties need the help of group and private investors. That is to say, REITs provides exit channels for private funds, while private funds provide mature properties for REITs. Mutual support becomes the key of Cade fund model. Therefore, Capitaland promotes the development of private real estate funds and REITs at the same time.

Vanke imitates the Capitaland model, introduces different funds in different stages of commercial real estate projects, light asset operation, and gains profits in all aspects. In the project development stage, Vanke Group introduces short-term private equity funds for joint development, and then introduces commercial funds in the opening and cultivation stage. It transfers them to long-term REITs after mature cultivation.

5. Conclusion

In the era of Mainland China's real estate reserves, financial innovation is needed to promote the sound development of the real estate market. Both Private Equity Real Estate, which has been more active in Mainland China, and REITs, which has not been promoted to commercial real estate, have great development potential in the future. It can be predicted that the joint operation mode of Private Equity Real Estate and REITs will become one of the important modes of Mainland China's real estate financial market in the future, which is the development trend of Mainland China's real estate market entering the stock age.

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