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REITS: Further options for the real estate market in Serbia

In the spirit of the address given by Serbia’s Minister of Economy and Regional Development yesterday, I would like to give you today a brief introduction regarding an attractive investment vehicle: the Real Estate Investment Trusts (REITS) market.

The origins of the real estate investment trust, or REIT, are to be found in the United States of America and date back to the 1880’s when investors were given the chance to avoid double taxation because trusts were not taxed at the corporate level if income was distributed to beneficiaries.

Prior to 1960, only wealthy individuals had the necessary financial resources to invest in significant real estate projects but in 1960 President Eisenhower signed the Real Estate Investment Trust Act introducing financial incentives for those wishing to invest in REITS thus, giving to anyone and everyone the ability to invest in large-scale commercial properties.

Three (3) years later, the first REIT was formed providing the same opportunities to the average American as were available to the elite.

Today, following a few legislative improvements, such as the Tax Reform Act of 1986 and the 1993 elimination of REIT investment barriers to pension funds, there are almost 200 REITS operating in the United States alone.

Other non European countries which have well- established, or newly formed REITS are: Australia, Japan, Singapore, Hong Kong, New Zealand and South Korea.

Europe is a diverse region in political, economic and social terms. Every country has its own political system, determining its own legal and fiscal framework (within European Union Guidelines).

Of the European Countries France, Belgium, Greece, the Netherlands, United Kingdom have clear, tax - efficient REIT legislation in force. Germany is about to enact on REITS. Italy and Spain utilize a hybrid structure which means that their REITS combine investment in both properties and mortgages. Russia and Turkey also have existing REIT structures.

But what IS a REIT? And why does it constitute an interesting option for the real estate market in Serbia?

A REIT is a company that owns and in most cases operates income-producing real estate. Some REITS finance real estate. To be a REIT, a company must distribute at least 75%, elsewhere 90% of its taxable income to shareholders annually in the form of dividends.

REITS have a very diverse profile, the industry offers investors many alternatives across a broad range of real estate property sectors, including:

Apartments

Office properties

Shopping centres

Regional malls Storage centres

Industrial parks and warehouses

Lodging facilities, including hotels and resorts

Health care facilities

Natural resources

The concept of REITS is simple. Instead of investing directly in real estate property with the aim of receiving an annual profit of 7% - 8% while at the same time undertaking all risks related to owning and exploiting real estate, investors will be able to become co – owners in a series of real estate property and to receive a noteworthy portion of rental income without worrying about the management of the property. All these mean that, REITS companies manage real estate property portfolios and private investors have access to these portfolios via the stock market.

The advantages of REITS are:

- **Convenience**

It relieves the investor of the necessity to select, acquire, register and sell real estate properties. In addition to that, the investor is free to exit, irrespective of construction work status.

- **Professional management**

It relieves investors of the necessity to assess projects on their own and minimizes the risks of real estate transactions.

- **Taxation**

With some exception, REITS are not taxed on the income they distribute to shareholders. This avoids the double-taxation problem of regular corporations. One of the requirements for REITS is that they distribute nearly all of their income to shareholders annually to avoid a penalty tax.

- **Diversification**

According to a study by Ibbotson* (commissioned by NAREIT*) between 1998 and 2004 that examined REIT and non-REIT portfolio performance, there are no substitutes for the diversification benefits of REITS. In all cases where there is an inclusion of REITS in a portfolio we have increased returns and reduced risk.

- REIT shares are more liquid than investing directly in real estate

Liquidity is a key investment criterion and a strong selling point of Real Estate Investment Trusts. It is much easier to liquidate shares of a REIT than it is to sell office buildings, rental property, or other real estate. A reason for this liquidity is that REIT shares are typically traded on major exchanges, making it easier to buy and sell REIT shares than to buy and sell properties in the private market.

- Legal protection

Share holders own shares of the REITS property. The law provides protection for such property against external claims in connection with the Asset Management Company's liability. Therefore, there is a guarantee that shareholder's interests are well protected.

- Transparency

Most REITS operate along a straightforward and easily understandable model and have an open investment portfolio structure. When reporting financial results, REITS must report regularly and must report earnings per share based on net income as defined by generally accepted accounting principles.

Now I would like to give you an account of the individuals or bodies interested in REITS:

- Financial investors are interested in REITS because they perform high annual yields with limited risks.
- Institutional investors (banks, insurance companies, pension funds) are interested in REITS because they have collected capital and look for profitable investments worldwide. REITS are a good option in their portfolio strategy.
- Founders of REITS (banks, individuals etc) find REITS an attractive option to build a profitable business platform.
- Private Equity Funds in the field of real estate find that REITS is a way to exit their short term engagement.

- [Owners of large real estate portfolios](#) (companies or the public sector) find REITS an attractive option to sell real estate since these sales enjoy privileged taxation.
- [States and public institutions](#) can privatize their public real estates should they wish to do so. They may also earn from taxes paid in the process.
- [Competing governments and global cities](#) can find REITS to be a vehicle for strengthening their financial business and stock exchanges.

As I have already told you earlier on, REITS are spreading not only in Europe but around the world, putting property in play. Specialists agree that REITS will bring a new level of openness and market discipline.

There are already 23 countries worldwide that either have or are planning to have clear and functional REITS legislation. The first country to legislate has been USA while United Kingdom just joined and Germany is expected to join very soon.

In Greece we have a legal framework since 1999 and we continue to improve our legislation as two amendments of the initial law in 2002 and 2007 show. It seems that each improvement in our legislation speeds up the developments.

Already, there are two REITS in Greece: Eurobank and Piraeus Bank and Marfin Bank is anticipated to enter the sector very soon.

In June 2007 my law offices organized an International Conference in Athens on 'Modern Means of Investment in Real Estate' where prominent specialists from Greece and abroad addressed the issue. They have all been very excited about the prospects and the recent developments in the sector.

The conclusions drawn at the conference were that:

REITS gradually but steadily become a major aspect of European investment strategies in real estate.

The legal framework is more or less the same in all countries where relevant legislation is in force with emphasis on taxation incentives.

Europe is moving fast towards the expansion of the sector and in the countries that have just introduced or are about to introduce REITS legislation, such as the UK and Germany, the expected capital is calculated to exceed the amount of 100 billion euros during the next five years.

The possibility of a Pan-European REIT, where, irrespectively of the country that you invest, you will be able to enjoy the same benefits, and especially those relating to taxation is expected to stabilize the sector's growth and attract foreign investors to the countries.

When considering introducing legislation about REITS in a country, attention must be drawn to the following factors:

A healthy and stable property market is a key element in any successful economy, both to individuals, as a form of housing and long term security, and in the commercial sector, as a major factor of production.

Allow me at this point to borrow the four key objectives of the UK legislation which I find thorough, comprehensive but above all a good general basis for reform:

- Improving the quality and quantity of finance for investment in commercial and residential property;

- Expanding access to a wider range of savings products on a stable and well regulated basis;
- Protecting all taxpayers by ensuring a fair level of tax is paid by the property sector; and
- Supporting structural change in property markets to reduce costs and improve flexibility and quality for tenants.

The introduction of REITS in a country would mean boosting real estate investments and adding depth and sophistication to the country's real estate market.

In addition, and in relation to the possibility of a Pan-European REIT market, I should mention that the first step towards a common European REIT is to establish REITS in more countries throughout Europe.

Finally, I would like to stress the fact that REITS have the potential for long-term capital appreciation that historically has met or exceeded inflation.

Closing now my address, ladies and gentlemen, I do hope that, I have made a small contribution to the elaboration of a new prospect for the development of Real Property Investment Law in Serbia.