GIFT

GOVERNANCE
INDEX
FOR
TRUSTS

GOVERNANCE INDEX FOR TRUSTS (GIFT)[1]

Key Findings

June 2017

[1]The Governance Index for Trusts – GIFT - is produced by Associate Professor Mak Yuen Teen and Chew Yi Hong, authors of this report, and supported by CPA Australia. The following individuals contributed to the development of GIFT: Alethea Teng Shuyi, Au Mei Lin Eunice, Wu Wenjing and Yap Hui Lin.

1. INTRODUCTION

Real estate investment trusts (REITs) and business trusts (BTs) have become an important feature of the Singapore capital market. As at 1 June 2017, there are 45 such issuers with a primary listing on the Singapore Exchange (SGX), accounting for a total market capitalization of $85 billion. Of the 45 issuers, six are constituted as stapled securities (SS), nine[2] as pure business trusts and 30 as REITs.

Existing governance indices in the Singapore landscape exclude this important group of issuers because their governance structures and practices, and applicable rules and regulations, are different from companies. One important difference, for example, is that with one current exception, REITs and BTs are externally managed by a manager and trustee-manager respectively, with the board of directors (and management) residing with the latter and appointed by them[3]. This creates a wedge between unitholders and the board of directors, leading to potentially reduced accountability compared to the case of a listed company. While regulators have introduced requirements imposing fiduciary duties on directors of the manager to unitholders that are equivalent to companies, unitholders of trusts generally have no right to nominate directors, or to elect or remove them - although some managers now provide unitholders with the right to endorse the appointment of their directors.

The Governance Index For Trusts (GIFT) was developed specifically for listed REITs and BTs and recognizes their unique features compared to listed companies. In developing GIFT, we took into account differences in business models of listed trusts, applicable regulatory requirements, the Code of Corporate Governance, and the MAS consultation paper on proposed enhancements to the regulatory regime governing REITs and REIT managers, including certain proposals that were not implemented after the public consultation.

For this inaugural issue, the trusts were assessed by Associate Professor Mak Yuen Teen and Chew Yi Hong using publicly available information from annual reports, websites, presentations and other SGXNET announcements of the trusts, and news media reports.

Anonymous emails to investor relations contacts provided by the trusts were also used to assess actual responsiveness to investors.

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[2] The nine pure BTs exclude Indiabulls Property Investment Trust and Rickmers Maritime that have been suspended and are excluded in the ranking.

[3] For brevity, when we use the term “trusts”, we are referring to both REITs and BTs collectively. When we use the term “managers”, it includes trustee-managers in the case of BTs. We also use the term “trust” and “manager” interchangeably even though governance of REITs and BTs is really about the governance of the manager, not the trust, since REITs and BTs are almost always externally managed in Singapore.

2. METHODOLOGY

The index includes a main section carrying an overall score of 100 points. 80 points are allocated to the following areas of governance: board matters (20 points), remuneration of directors and key management (10 points), alignment of incentives and interests (10 points), internal and external audit (10 points), communication with unitholders (15 points) and other governance matters (15 points).

Twenty (20) points are allocated to business risk, assessed using leverage-related factors of overall leverage, debt maturity, percentage of fixed interest rate borrowing; and other factors relating to development limit, lease expiry and income support arrangements.

There are some differences in terms of criteria and weighting for REITs and BTs to take into account differences in regulatory requirements and business models.

In addition to the main section, there is a section comprising merit and demerit points. Merit points are given for certain practices that we believe trusts should aspire to adopt in order to further improve their governance or to reduce their risks. Examples include putting trust deeds and loan agreements on websites and avoiding hybrid securities that are classified as equity but have debt-like features. Merit points ranged from one to three points per item and the maximum number of merit points is 25.

Demerit points are given for cases such as independent directors serving on boards of a related manager or on an excessive number of directorships in listed companies and managers. Demerit points generally range from minus one to minus three, although certain serious governance issues can incur as many as 10 demerit points per item.

The full index is available at www.governanceforstakeholders.com.

3. COVERAGE

In this inaugural issue of the index, we assessed 43 trusts, including six that are stapled. Two trusts were excluded from the scoring as they are newly listed and have not published their annual reports. Of the six stapled securities, three of them have dormant business trusts. The stapled securities were scored mostly as REITs but where relevant, the stricter standards for BT governance was applied to the stapled securities.

Ascendas REIT and CapitaLand Mall Trust are the two largest REITs with market capitalisation of more than $5 billion. Another 25 trusts are in the billion-dollar club. Of the 16 remaining trusts, 15 have market capitalisation of more than $300 million to $1 billion, with just one exception below the $100 million market capitalisation level.

Of the 35 REITs in the index, 24 have the majority of their assets in Singapore. Four others have the bulk of their assets in China and/or Hong Kong and a further three are Australia-centric. The remaining four are focused on Indonesia, Europe and a well-diversified portfolio.

Just one out of eight BTs is Singapore-centric. The remaining seven is a diverse group with geographic focus in China, India, Japan and Taiwan for assets such as shipping vessels, hospitals, ports, retail and industrial real estate, golf courses and Pay TV.

4. KEY FINDINGS

For the main index, the overall range of scores for the 43 trusts is from 49.5 to 76.5 out of a maximum of 100 points, with a mean of 65 and median of 66.

When merit and demerit points are included, the overall range of scores is from 38.5 to 76.5, with a mean of 62 and median of 62. The total score, including merit and demerit points, is a more complete measure of the governance of a trust.

Table 1 shows the distribution of scores for each of the seven areas of the main index.

4.1. Board matters

4.1.1. Appointment of directors

There is currently only one trust, Croesus Retail Trust, that is internally managed, having converted from its former externally-managed structure at its EGM held on June 30, 2016. With this internalization, unitholders are given the right to endorse the appointment of directors. There are 4 other externally managed trusts – Keppel REIT, Keppel DC REIT, OUE Hospitality Trust and Parkway Life REIT – that have also given the right for unitholders to endorse directors of the manager.

	Governance Risks						Business Risks
	Board matters	Remuneration of directors and key management	Alignment of incentives and interests	Internal and external audit	Communication with unitholders	Other governance matters	
Allocation of points	20 points	10 points	10 points	10 points	15 points	15 points	20 points
Average score	10	3.1	7.1	9.4	10.5	11.7	13.2
Highest score	16	6.5	10	10	15	15	18
Lowest score	4	0	4	6	5.5	6.5	3

Table 1: Distribution of scores for each of the seven areas of the main index

This gives unitholders some say in the appointment of these directors. Where the manager commits to procure the resignation of directors who are not endorsed by unitholders, the unitholders' vote becomes effectively binding. All the 5 trusts that give the right to endorse the appointment of directors also stated that they will procure the resignation of unendorsed directors.

However, currently no trust gives unitholders the right to nominate directors, rather than just endorse directors selected by the manager.

4.1.2. Board size

The average (mean) board size is 7.1 directors, with a range from four to eleven directors. Thirty-three trusts have a board size of six to nine directors, the range used in GIFT to determine appropriate board size. Managers and trustee-managers generally have fewer committees than listed companies and usually have only a single executive director (ED), the CEO, on the board. They can operate efficiently with relatively smaller boards than their listed company counterparts without compromising board effectiveness, if they have good processes for selecting the right non-executive directors (NEDs).

4.1.3. Board chairman

All but one of the managers have a non-executive chairman. Many also state that their chairman is an independent director (ID). We have re-designated a chairman from independent to non-independent under two situations: (a) where the tenure has exceeded 9 years, and (b) where he/she has significant relationships with the manager/trustee-manager or the sponsor (even where the nominations committee has deemed the director to be independent).

Relationships that we consider to be serious enough to cause a re-designation include significant consulting services (such as legal services) provided by the director or his/her firm, or concurrent service on the boards of a sponsor, controlling unitholder or related entities. We do the same for all IDs on the board other than the chairman.

After the re-designation, 17 trusts have an independent board chairman.

4. KEY FINDINGS

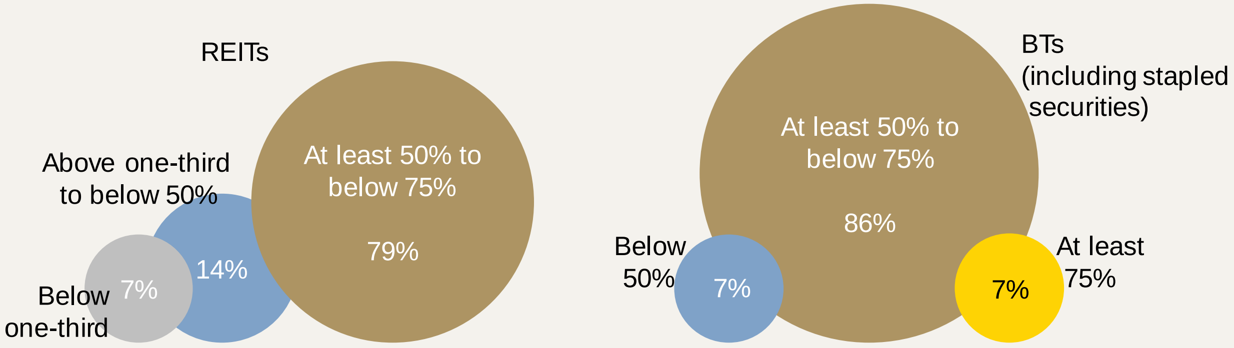


Figure 1: Percentage of Independent directors on the boards of REITs and BTs.

4.1.4. Independent directors and competencies

For the percentage of IDs on the board, we took into account the different regulatory requirements applicable to REITs and BTs in setting the ranges for different number of points awarded. For REITs, the ranges are: (a) above one-third and below 50%, (b) at least 50% and below 75%, and (c) at least 75%. For BTs, they are: (a) at least 50% to below 75% and (b) at least 75%. As mentioned earlier, some directors were re-designated from independent to non-independent directors. Figure 1 shows the percentage of REITs and BTs (including stapled securities) respectively within each of these ranges.

In terms of competencies, IDs commonly have general business, banking, accounting and legal experience. For trusts, having IDs who have investment/fund management experience and prior working experience in the industry is useful. Based on our assessment, 15 trusts have IDs having either of these type of experience, while 17 have IDs with both types of experience. This is a potential area of improvement for many trusts.

4.1.5. Board committees

Twenty-six of the trusts have formed nominating committees (NCs) and 27 have formed remuneration committees (RCs). Three NCs and four RCs had all IDs on the board committee. Many of the trusts had combined their Nominating and Remuneration Committees (NRC).

All the managers have established an audit committee (AC) or an audit and risk committee (ARC).

Figure 2 shows the percentage of each committee that have an independent chairman and the percentages that have all, majority and less than majority of IDs for each committee (after the re-designation of IDs to non-independent directors where applicable).

84% of the trusts have an independent AC chair assessed to have recent and relevant accounting or related financial management expertise or experience, and 60% have a majority of IDs having such expertise or experience. We are stringent in assessing this, focusing on both recency and relevance of the experience. For example, working experience in the financial industry may not necessarily be considered as relevant accounting or financial-related experience for the AC.

Trusts should consider adopting a more rigorous approach when assessing the recency and relevance of the accounting and financial management-related expertise and experience of directors appointed to ACs.

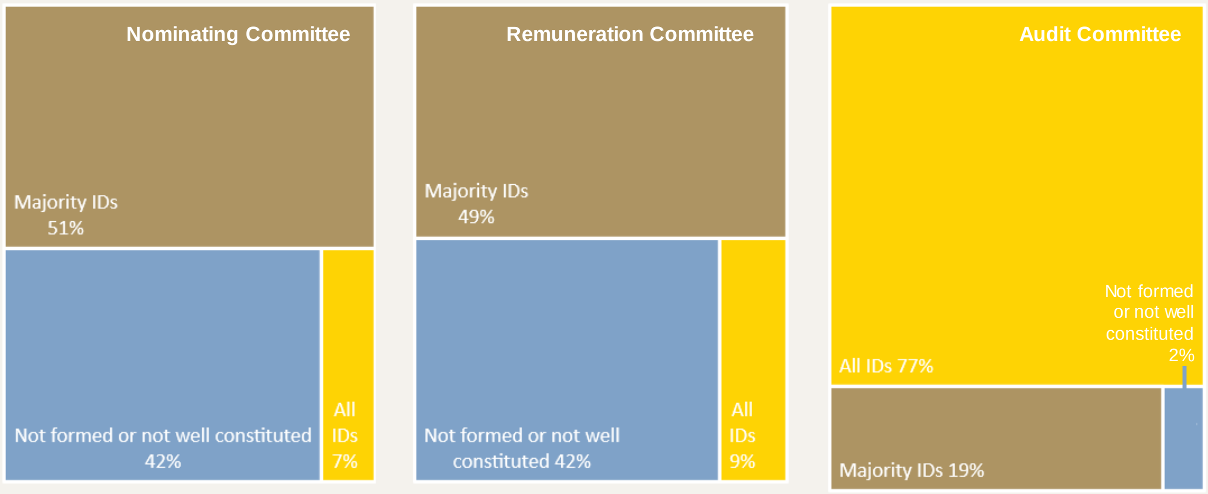


Figure 2: Percentages with independent chairman and composition of independent directors in the NC, RC and AC.

4. KEY FINDINGS

4.2. Remuneration of directors and key management

Disclosures are better when it comes to remuneration of NEDs compared to the remuneration of EDs and key management. For NED remuneration, 77% disclosed the actual remuneration of each individual NED on a named basis. However, only 16% disclosed the fee structure.

Just over more than half of trusts disclose the remuneration components and rationale for having these components for their CEO and EDs. When it comes to the remuneration amounts and breakdown for the CEO, other EDs and key management, many trusts do not even provide disclosures in bands. They often cite competitive reasons and sensitivity for non-disclosure. In addition, many argue that their remuneration is paid by the manager and not by the trust.

In our view, such remuneration is ultimately borne by the trust and unitholders, and excessive or inappropriately designed remuneration packages would affect the efficiency and effectiveness of the manager or trustee-manager in managing the trust.

Ten of the trusts link the remuneration of the EDs at least partly to total unitholder return and five to distribution or NAV per unit.

Figure 3 shows the key remuneration disclosures and practices of the trusts for items in the main index.

Trusts should improve their disclosure of remuneration, especially for EDs and key management.

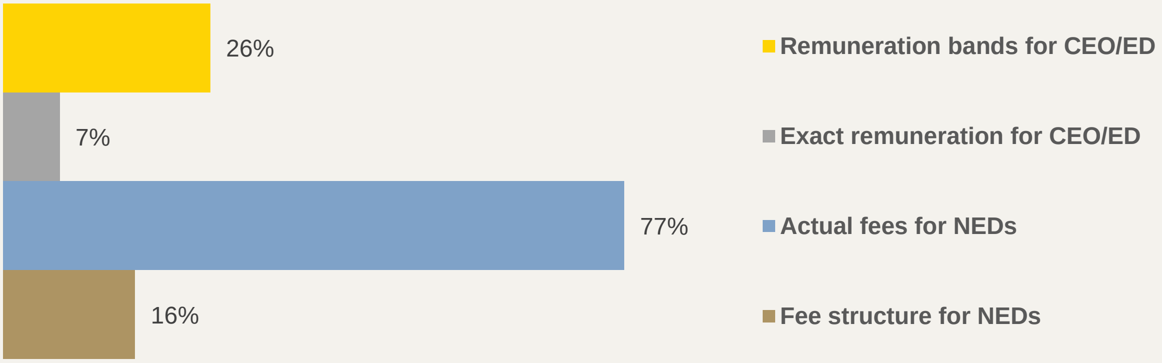


Figure 3: Key remuneration disclosures and practices for REITs and BTs.

4.3. Alignment of incentives and interests

Trusts are generally transparent about the amounts of different fees paid to the manager and other entities providing services to the trust, including asset management fees (base and performance fees), property management fees, acquisition fees, divestment fees and trustee fees. Such disclosures are highly regulated by rules and regulations set by MAS.

Fourteen trusts use a return-type metric, distribution per unit (DPU) or net asset value (NAV) per unit to determine the performance fee of the manager.

However, 25 trusts link the performance fee to net property income. For at least two trusts, the existence of the performance fee for the trustee-manager was not mentioned at all in the annual report. Even though the managers have not met the criteria to earn the performance fee, this disclosure on the performance fee and how it is determined should be in the annual report for unitholders' benefit.

All but three of the trusts disclose that the acquisition fee is set at no more than 1% of the purchase price and the divestment fee at no more than 0.5% of the sale price. For two of them, the actual percentage is not disclosed, but merely stated as "entitled under the Trust Deed" which is not available online. All the trusts charge acquisition and divestment fees and none base these fees on a cost-recovery basis.

4. KEY FINDINGS

Overall, in the area of alignment of incentives and interests, there can be improvement in linking performance fees more closely to unitholders' interests such as total unitholder return or DPU and reducing the use of net property income as a performance measure, and adopting a policy requiring NEDs to hold some units until they leave the board.

4.4. Internal and external audit

Trusts fare well in having reputable external auditors and unmodified audit opinions. All but one received the full 6 points allocated to external audit. No trust had unexplained changes in the external auditor or modified audit opinion (adverse, disclaimer, qualified).

Similarly, the trusts did well in the area of internal audit. All disclosed that they had an internal audit (either in-house or outsourced). Just one of the trusts have an in-house internal audit function. Approximately half of the trusts outsourced to a reputable external firm (Big 4, mid-term or reputable risk consultancy firm), and the other half outsourced to the internal audit department of the sponsor.

We believe that the common practice of outsourcing internal audit to the internal audit department of the sponsor may undermine the perceived independence of the internal audit function, especially in providing assurance in areas relating to other functions that may be outsourced to the sponsor and related party transactions.

4.5. Communication with unitholders

4.5.1. Timeliness of results

Communication with unitholders is another area that trusts excel in. Just more than three quarters released their latest annual results within 45 days and about half released all their quarterly results since the beginning of their most recent full financial year within 30 days, even though the requirements are to release within 60 days and 45 days respectively (except for the fourth quarter which is 60 days).

4.5.2. Accessibility of information and investor relations

All the trusts have a website with a link to it provided on SGX or the annual report, with a dedicated link for investor relations (IR) on the website. Most had well-designed websites where information is relatively easy to find. All have their IPO prospectus on the website and all have at least the past five years' annual reports or all annual reports since IPO if listed for less than five years, usually in a subsection titled "Publications".

In terms of results announcements, all except one have a dedicated section for financial results for at least the past 12 quarters or since their listing dates.

We believe that the trust deed is an important document and should be made easily accessible to unitholders on the website of the trust. However, none of the trusts do so.

All the trusts also engaged with investors and analysts through meetings and/or conference calls and all but one put their presentation materials on the website.

All the trusts provide information for contacting IR, with just more than half providing a specific IR contact person with contact details and the rest providing either general contact details for an IR department or only an enquiries form to be filled up and submitted online.

We also emailed all the IR contacts as an anonymous investor, posing some basic questions. Thirty-four trusts were fast and helpful in their replies and responded within five business days. The remaining nine did not respond by the cut-off time two weeks later.

4.5.3. Unitholder meetings

Twenty-three trusts give at least 21 days' notice for meetings with unitholders, and at least 28 days' notice where the meeting includes a special resolution, compared to the requirements of 14 days and 21 days respectively. Twenty-seven did not hold their AGMs within the last 5 business days of the peak months of April, July or October.

All but one make the presentation materials for their AGM/EGM available on their website and/or SGXNET. Disappointingly, just one trust made detailed minutes of their latest AGM available on their website or SGXNET.

4. KEY FINDINGS

4.6. Other governance matters

4.6.1. Key management experience

Good governance needs to be supported by a strong management team. One of the key areas we assessed here is the length of working experience of the Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Head of Investment or Asset Management, or their equivalents, in the industry in which the trust operates.

Table 2 shows the distribution of these three key management positions with (i) experience of ten years or more, (ii) five to ten years and (iii) below five years. Where some trusts have scored lower, it was the result of unclear or insufficient disclosure.

4.6.2. Rule of law

Where a trust operates mainly in a country with strong rule of law, there is likely to be better protection of investor and property rights. We consider countries in the top 25th percentile of the World Bank Governance Indicators as having strong rule of law. For the trusts assessed, 28 trusts operate mainly in Australia, Germany, Hong Kong, Japan, Singapore, United States.

4.6.3. AC review of interested person transactions

Thirty-seven trusts clearly state that the AC reviews all interested person transactions (IPTs). The other trusts only state that the AC reviews controls, policies and procedures relating to IPTs or internal audit reports on IPTs, or that it only reviews IPTs above a certain threshold.

	Chief Executive Officer	Chief Financial Officer	Head of Investment or Asset Management, or their equivalents
Experience of ten years or more	74%	53%	79%
Experience of between five to ten years	14%	26%	12%
Experience of below five years	12%	21%	9%

Table 2: Experience of key management

4.6.4. Entrenchment of manager

Managers of trusts are generally entrenched to some extent as it is not easy to replace a manager even if public unitholders are dissatisfied with its performance. However, the higher the percentage of units held by sponsor or controlling unitholder, the harder it is for public unitholders to replace the manager. For REITs, the rules provide that the manager can be removed by a majority of unitholders, while the trustee-manager of a BT can only be removed by 75% of unitholders. Therefore, it would be impossible for public unitholders to remove a manager if the sponsor/controlling unitholder retains 50% of the units in the case of a REIT and 25% (plus one unit) in the case of a BT. Thirty-one of the trusts were assessed to have less entrenchment.

No trust currently provides that the manager is subject to periodic re-appointment by all unitholders. We believe that unitholders recognise the value of retaining an experienced manager or trustee-manager and will not trivialise a decision to change even if they are able to. Perhaps giving unitholders a right to endorse the re-appointment periodically - effectively an advisory rather than a binding vote - would be a good way to gauge the satisfaction of unitholders with the performance of the manager or trustee-manager.

4.6.5. Stapling of REIT/BT

Stapling a trust with another trust further complicates the trust structure, changes its risk-return profile and reduces investor choice (who can purchase individual trusts on their own if they so wish). This is especially so if the trusts are in unrelated businesses. Only six of the trusts included in our assessment are stapled and they are stapled to a trust in a related business.

4. KEY FINDINGS

4.6.6. Other negative governance events

Various other negative governance events are taken into account in assessing the governance of the trusts, such as turnover of directors and key management; regulatory issues related to the trust, directors and key management; and non-compliance with laws, regulations, rules and codes.

These negative governance events are rare, but they are important to include in the index to help ensure that the index score better measures the substance of the governance of the trust.

Table 3 shows five negative governance events applicable to some trusts and the number of demerit points deducted for each event.

4.7. Business risk

In GIFT, 20 points are allocated to factors related to business risk, comprising: (a) leverage-related factors of overall leverage, average debt maturity, percentage of debt maturing within 12 months and percentage of borrowings carrying fixed interest rates; (b) volatility of daily returns over the financial year; (c) change in weighted average lease expiry (WALE) from prior year; and (d) extent of income support arrangements. For REIT, a fifth factor, percentage of development limit, was included, with the weightage for overall leverage reduced.

Common negative governance events	Demerit points
Regulatory action was taken against a director, KMP (including CEO, CFO, CIO or COO) and he/she continues to stay on the board within 3 years of the action	10 demerit points
Any of the directors or KMPs resigns and raises corporate governance-related concerns	5 to 10 demerit points
CEO, CFO, CIO or COO of the REIT Manager/BT Trustee-Manager resigns without adequate disclosure of the circumstances	3 demerit points
Non-compliance with any Rules, Regulations, Codes or Acts	3 to 10 demerit points
Disclosure-related lapses resulting in queries from the Exchange	2 demerit points

Table 3: Negative governance events with demerit points

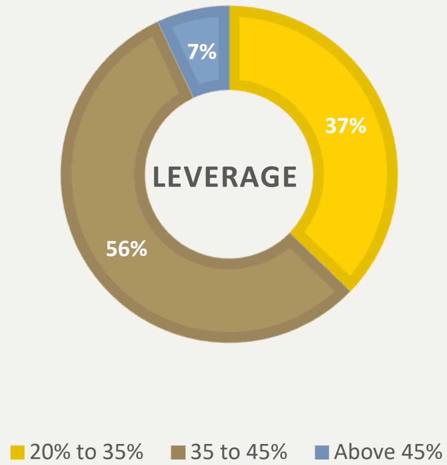
Figure 4 shows how the trusts fared in terms of the distribution of the level of leverage, the weighted average debt expiry and the weighted average lease expiry.

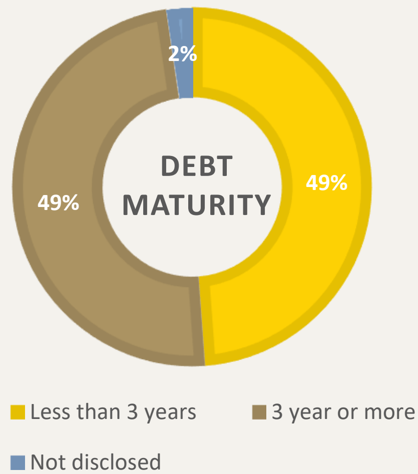
For volatility of returns, each trust is evaluated against other trusts.

In the case of WALE, we differentiate between those with a WALE of at least five years or with an increase in WALE compared to the previous year, from other trusts with a WALE of less than five years and a constant or decrease in WALE. Twenty-four trusts have a WALE of at least five years or an increase in WALE. Six have a WALE of less than five years and a constant WALE, and nine have a WALE of less than five years and a decrease in WALE.

About four-fifth of the trusts did not disclose any income support arrangements or disclose that they did not have such arrangements. The other trusts have some form of income support arrangements, with three trusts having income support exceeding 10%.

For REIT, we include development limit as a fifth factor related to business risk. Recent MAS regulatory changes allow REITs to exceed a 10% development unit with the approval of unitholders. A higher development unit exposes the REIT to higher risk. We did not find any REIT seeking unitholders' approval to increase the development limit in this round of assessment.





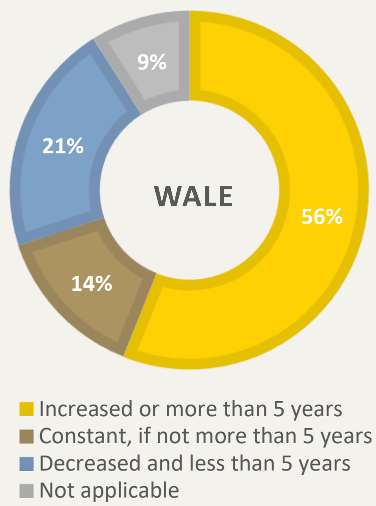


Figure 4: Distribution of the level of leverage, the weighted average debt maturity and weighted average lease expiry.

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Ranking	REIT/BT	Main Score	Total
1	Keppel DC REIT	74.5	76.5
2	Parkway Life REIT	71.5	74.5
2	Soilbuild Business Space REIT	76.5	74.5
4	AIMS AMP Capital Industrial REIT	75.0	73.0
5	Starhill Global REIT	69.5	72.5
6	Cambridge Industrial Trust	74.5	71.5
7	Keppel Infrastructure Trust	70.0	71.0
8	CapitaLand Commercial Trust	68.5	70.5
9	IREIT Global	71.0	70.0
10	Ascendas India Trust	70.5	69.5
11	Manulife US REIT	71.0	69.0
11	Mapletree Industrial Trust	72.0	69.0
11	SPH REIT	67.0	69.0
14	Frasers Commercial Trust	65.5	68.5
15	CapitaLand Mall Trust	66.5	66.5
15	Mapletree Commercial Trust	69.5	66.5
17	BHG Retail REIT	69.0	66.0
18	Frasers Hospitality Trust	64.5	65.5
19	Ascendas REIT	68.0	65.0
19	CapitaLand Retail China Trust	66.0	65.0
21	First REIT	66.0	64.0
22	Ascendas Hospitality Trust	68.0	62.0
22	Ascott Residence Trust	69.0	62.0
22	Keppel REIT	74.0	62.0
22	OUE Commercial REIT	65.0	62.0
26	Mapletree Greater China Commercial Trust	63.0	61.0
27	Croesus Retail Trust	60.0	59.0
28	Far East Hospitality Trust	63.0	58.5
29	CDL Hospitality Trusts	56.5	58.0
29	Frasers Centrepoint Trust	57.0	58.0
29	Suntec REIT	58.0	58.0
32	Viva Industrial Trust	62.5	57.5
33	Cache Logistics Trust	58.5	55.5
34	OUE Hospitality Trust	57.5	54.5
34	Sabana REIT	69.5	54.5
36	Mapletree Logistics Trust	62.0	54.0
37	Accordia Golf Trust	53.5	53.5
38	EC World REIT	65.0	52.0
39	Asian Pay Television Trust	50.5	50.0
40	RHT Health Trust	53.0	49.0
41	Hutchison Port Holdings Trust	49.5	46.5
42	Lippo Malls Indonesia Retail Trust	57.5	45.5
43	First Ship Lease Trust	52.5	38.5

ABOUT THE AUTHORS

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Mak Yuen Teen is an Associate Professor of Accounting at the NUS Business School, National University of Singapore, where he teaches corporate governance. Prof Mak holds first class honours and master degrees in accounting and finance and a doctorate degree in accounting, and is a fellow of CPA Australia.

He served on committees that developed and revised the Code of Corporate Governance for listed companies in Singapore in 2001 and 2005. He is a member of the Corporate Governance Council formed by MAS to review the Code in 2017.

Prof Mak developed the Governance and Transparency Index (GTI) and the Governance Evaluation for Mid- and Small-Caps (GEMS) and was the Singapore expert involved in developing the ASEAN Corporate Governance Scorecard.

For more information about Prof Mak's work, please visit his website at www.governanceforstakeholders.com.

Chew Yi Hong

Chew Yi Hong is an active investor and a keen observer of the corporate governance scene. He received an MBA with Distinction from the London Business School and graduated from Cornell University with dual degrees in Economics and Electrical Engineering.

Prior to his time spent at a Big 4 public accounting firm, he consulted for a global fund to address corporate governance issues of a listed issuer. Mr. Chew has also researched on other areas of corporate governance including board and senior management diversity in the public and private sectors, and across major Asian economies.

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