SUPPORTED BY

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GOVERNANCE INDEX FOR TRUSTS 2020
Volume 4

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FOREWORD BY TAN BOON GIN

This latest edition of GIFT emphasizes substance over form. I am heartened to see this as we at SGX RegCo have long advocated embracing the spirit rather than just observing the letter of the rules. That GIFT 2020 has taken this new approach affirms how crucial such a culture is to the sustainability of the REITs and Business Trust sector.

Changes have been made in the GIFT 2020 scoring to reflect this new emphasis. Adjustments also had to be made to take into account the impact of COVID-19. The scores are therefore not directly comparable to the previous years'. Average scores are naturally lower against this higher standard but should not be of concern at this nascent stage.

In the area of business risk, the sector remains strong despite the challenging environment. Half the trusts still have healthy weighted average debt maturity of more than three years and more than three quarters have less than a quarter of debt maturing in the next 12 months.

Improvement was noted in areas such as the posting of detailed minutes of AGMs, and disclosure of the actual remuneration of each individual non-executive director on a named basis. More trusts also reported, and in greater detail, the performance measures used to determine the remuneration of the CEO.

Also new in GIFT 2020 is the focus on the remuneration framework of trusts. It is noteworthy that two- thirds of trusts have in place a long-term component in their frameworks to better align the interests of management and unitholders. The report also noted that trusts provided longer notice periods for general meetings (at least 21 days for meetings with no special resolution and at least 28 days for meetings with special resolution) compared with last year.

FOREWORD BY TAN BOON GIN (CONT'D)

Some of the concerns highlighted in GIFT 2020 about independent directors are inherent in an externally managed trust, which is the preferred model in the sector for commercial reasons. It is notable that some trusts have chosen to go beyond what is strictly required by the rules and allowed unitholders to endorse the directors of the manager at the AGM.

The success of the sector has not gone unnoticed. Other international markets are beginning to offer their own REITs and Business Trusts. To maintain our edge, we must continue to improve the sector, both in terms of the diversity of our listings and the quality of our governance.

GIFT 2020 also highlighted that the use of hybrid securities such as perpetual securities is growing. We must continue to educate and inform investors to ensure that they understand what this means to the financials of the trust, including its cash-flow and risk profile.

We are guided by GIFT in prioritizing our regulatory efforts. This year, we will focus our energies on how the management of the trust, the board of its manager and its auditors make disclosures, particularly following the transition to half-yearly financial reporting.

At the same time, we strongly urge trusts to consider areas which have drawn public scrutiny, including undertaking a rigorous assessment to determine if directors are independent and alignment of interest between managers and unit-holders. In the final analysis, investors will scrutinize directors' judgement on these and other substantive matters and not merely that the trusts had followed a checklist of requirements.

Tan Boon Gin
CEO
Singapore Exchange Regulation

EXECUTIVE SUMMARY

The Governance Index for Trusts (GIFT), first launched in 2017, is supported by the Singapore Exchange. MoneySense, the national financial education programme, provides a link to GIFT to assist investors assess if they are comfortable with the corporate governance of REITs. We appreciate their support.

In 2018, we started providing an opportunity for trusts to submit a self-assessment which we take into account in our assessment. This year, trusts were able to do this online and we are pleased that 35 out of 45 trusts, or 78%, participated in the self-assessment. This is the highest participation rate so far. We would like to thank those who responded for engaging with us on this initiative and look forward to the continuing engagement from all the trusts listed on SGX.

For this fourth edition of GIFT, 45 real estate investment trusts (REITs) and business trusts (BTs) listed on SGX were assessed, compared to 46 in 2019.

Five trusts which are currently listed were excluded – RHT Health Trust because it is a cash trust and currently suspended; Eagle Hospitality Trust (EHT) because it is suspended with its annual report only issued after the cut-off date; and three newly-listed trusts which have not yet published their annual report by the cut-off date - Elite Commercial Trust, Lendlease Global Commercial REIT and United Hampshire US REIT.

Three trusts were taken over and merged with other trusts and no longer listed on SGX. Two trusts are new in the 2020 edition – Prime US REIT and ARA US Hospitality Trust.

For GIFT 2020, we reduced the weighting for internal and external audit in the governance section from 10 to 5 points, and increased the weighting for the business risk section from 20 points to 25 points.

Another change in GIFT 2020 is that we have used the latest available quarterly/half-yearly results to assess business risks to make GIFT even more timely. All but one of the trusts were assessed based on the June 2020 results or operational/financial update. The only exception was a REIT that published its third quarter results that ended on 31 May 2020.

EXECUTIVE SUMMARY (CONT'D)

As with previous editions of GIFT, personnel changes to the board and senior management were assessed up to the cut-off date, which was the end of July 2020.

For certain items, especially those relating to business risks, we used a more graduated scale to reflect where a trust is on the risk spectrum – rather than say three points or zero points, it is now three points, 1.5 points or zero points. This should mean that trusts can earn partial points for hitting the less demanding threshold.

Raising the bar

This year, we decided to focus even more on substance and recognise trusts going beyond the bare minimum, rather than mere disclosure and practices which trusts would be expected to have anyway, such as the existence of a website. This raising of the bar means that average scores would be expected to be lower than previous years.

With the sector having matured, increasing consolidation, more trusts venturing overseas and the debacle involving EHT, it is important that corporate governance standards be raised and changing risks be adequately recognised so that the good work done by MAS and SGX in building up the sector in the past decade is not undone.

We also made adjustments to the scorecard take into account changes in regulation and the impact of COVID-19 on meetings. Given all the changes made, the scores for this year are not directly comparable to those in previous years.

The changes made to the scoring guidance are discussed in the later section on Methodology.

Overall trends for GIFT 2020

The top-ranked trusts in GIFT 2020 are Netlink NBN Trust, Keppel DC REIT, AIMS APAC REIT, CapitaLand Commercial Trust, Manulife US REIT and Mapletree North Asia Commercial Trust (the latter three trusts in joint fourth place). The highest score is 90 obtained by Netlink NBN Trust, which was also ranked top last year when it debuted in GIFT.

EXECUTIVE SUMMARY (CONT'D)

At the other end, the six lowest-ranked trusts are Asian Pay Television Trust, First REIT (joint fifth last), Lippo Malls Indonesia Retail Trust, Accordia Golf Trust, Dasin Retail Trust and Hutchison Port Holdings Trust, with the lowest score of 39 obtained by Hutchison Port Holdings Trust.

Bearing in mind the changes to the scorecard and scoring methodology, the average combined governance and business risk score slipped to 64.3 in GIFT 2020. Prior to this, the score was improving since the first edition of the study, increasing from 62.2 in 2017 to 65.6 in 2018 and to 68.0 in 2019. However, while changes to the scorecard and scoring methodology account for much of the overall dip in scores, there are areas such as independence and competencies of directors where standards could be better even for some of the trusts that have done well. Overall, we feel that standards have stagnated somewhat or even declined. Only a fifth of the trusts scored higher in GIFT 2020.

The two new entrants, Prime US REIT and ARA US Hospitality Trust debut at joint 10th and 24th respectively.

Excluding the two new trusts, the overall average score for those trusts that were in both last year's and this latest edition decreased from 68.1 to 64 points.

The top-ranked Netlink NBN Trust, with a score of 90, is the only trust in the top eight not to slip in its score. Its high score could be partly attributed to its internalised trustee-manager model which avoids many of the pitfalls of externally managed trusts, the prevalent model in the Singapore REIT and BT sector.

Since 2018, we have separately disclosed the score for the governance and business risk areas. The average governance score is lower at 48.0 (out of 75) while it averaged 54.3 (out of 80 points) in 2019. The average business risk score is 16.3 (out of 25 points) while it was 13.7 (out of 20) last year.

EXECUTIVE SUMMARY (CONT'D)

New merit and demerit items

This year, we introduced some new merit and demerit items.

In GIFT 2020, the experience of directors and the CEOs was assessed if the REIT/BT ventures overseas, a trend that we have observed. Demerit points were given at both the board and/or CEO level if there is no prior working experience in the new geographic area(s) for the independent directors and the CEO respectively. Five trusts received the demerit point for the lack of experience in the CEO and thirteen trusts for the board.

A new merit item was added for the level of engagement the board and key committees had with the trusts. Merit points were given if the board had least six meetings, the audit committee at least four, and the nominating and remuneration committees at least two. Thirteen of the trusts received merit points for this.

Another new merit item was based on diversity of the board, measured in a multi-dimensional manner by considering gender, ethnicity and age. We gave merit points for trusts that have directors of both gender (34 boards), more than one ethnicity (29 boards), and with at least one director who in his/her 40s or below (28 boards). Fifteen trusts have all three attributes in place and were given the merit points. Three trusts had none of the three attributes.

Another new demerit item was attendance of directors, with a trust receiving demerit points if a director misses two or more board or committee meetings in the financial year and/or does not have full attendance in both of the two most recent years. Fourteen trusts received demerit points for 27 such occurrences.

Also, as a new demerit item, if the ED, CEO, CFO, CIO or other key management of the manager or trustee-manager resigns within 18 months of listing, the trust will get three demerit points. This is to take into account concerns about the appointment process and lack of stability for key management, and the possibility that the key management was appointed to meet the due diligence requirements expected in an IPO.

We also introduced a new demerit item for those trusts that pay perpetual securities holders an amount that is more than a quarter of the distributable income. This is to differentiate the trusts that rely heavily on perpetual securities, which under the current accounting rules are considered equity and not debt.

EXECUTIVE SUMMARY (CONT'D)

In addition, we finetuned the assessment of the alignment of interest between unitholders and the manager. Previously, as long as DPU was increasing, the trust did not receive demerit points. For GIFT 2020, if fees paid to the manager increased while DPU dropped, the trust will receive demerit points. In addition for this year, if fees increased faster than DPU increased or decreased slower than DPU decreased, the trust gets a partial demerit point. Disappointingly, a third of the trusts received the full demerit points and a further two-fifths received the reduced demerit point.

Few areas of across-the-board improvement

Last year, we reported that the greatest area of improvement was the posting of detailed meeting minutes on the website of the trusts, with 29 of the 46 trusts having done so. This year, all but two posted their minutes but this improvement was mostly due to COVID-19 measures introduced by ACRA, MAS and SGX which require issuers holding meetings under these measures to do so. The two that did not post detailed minutes held their meetings prior to the pandemic. We hope that trusts will continue to post detailed minutes after the COVID-19 measures are no longer in place.

Last year, 87% disclosed the actual remuneration of each individual NED on a named basis. This year, all except one disclosed, although one only did so after it was queried by SGX.

More trusts disclosed the performance measures used to determine the remuneration of the CEO. Often the disclosures were more detailed, with more trusts stating that they use a unitholder-centric metric such as total unitholder returns as the key performance indicator (KPI). This resulted in more trusts earning two points (42% vs 33%) instead of partial points (20% vs 33%) while the percentage of trusts scoring no points was relatively stable (38% vs 35%). One REIT that previously used DPU as one of its criteria switched to using unit price performance and DPU yield. If DPU is constant, DPU yield increases as unit price drops. Using DPU yield as a KPI for management is an odd choice in our view.

Also new in GIFT 2020 is the focus on the remuneration framework of trusts. As REITs and BTs make long term investments, a properly structured remuneration framework for key management personnel (KMP), including CEOs and executive directors (EDs), should involve a long term component to better align the interests of the KMP with unitholders. We found that two thirds of the trusts have put in place a remuneration framework that includes a long term component (with 40% scoring the maximum points and 27% scoring partial points). A third of the trusts indicated that they do not have a long term component in their remuneration framework.

EXECUTIVE SUMMARY (CONT'D)

Most trusts held online AGMs and EGMs due to COVID-19, except five which held face-to-face meetings before COVID-19. ACRA, MAS and SGX issued guidance which strongly encouraged issuers to provide at least 21 calendar days' notice to shareholders. We found that more trusts (80%) provided longer notice period of at least 21 days for meetings with no special resolution and at least 28 days for meetings with special resolution.

In the business risk section, REITs promptly disclosed their interest coverage ratio (ICR) as required by MAS, with all but one reporting an ICR of above 2.5 times. Another REIT had an adjusted ICR of approximately 2.4 times if the distributions to perpetual holders were included. Out of the five stapled securities, one newly-listed hospitality trust achieved an interest coverage ratio of only 1.5 times. The BT has suspended its distribution for the first half of FY2020 barely a year after being listed.

Nevertheless, on average, REITs and BTs are still well financed. Approximately half of the trusts still have healthy weighted average debt maturity of more than three years, largely comparable to 2019 (49% vs 52%); and more than three quarters have less than a quarter of debt maturing in the next 12 months (78% in both years).

Areas where the sector has stagnated, regressed or not met expectations

- Appointment of directors

It is disappointing that the number of trusts that allow unitholders to endorse directors at the AGM remains at just five during the period of assessment – Keppel DC REIT, Keppel Infrastructure Trust, Keppel REIT, Netlink Trust and Parkway REIT. In the last week of September 2020, Starhill Global REIT published its notice of meeting which allowed for the endorsement of directors by unitholders at the AGM that is to be held on 28 October 2020. We recognise this positive development and made an exception to update its score even though this was past our cut-off date. We look forward to more trusts giving unitholders a binding endorsement vote for directors.

Given the fact that all directors of REIT managers and trustee-managers are appointed by the shareholders of the managers, and not the unitholders of the trust, it is difficult for independent directors to be perceived to be truly independent. The issue of independence of independent directors has arisen in several cases during the past year, and becomes particularly contentious in merger and privatisation situations. We believe that regulators should consider requiring trusts to seek such endorsement from unitholders, and the controlling unitholders, sponsor and their associates should abstain from the vote. In the extreme example of EHT, unitholders who are dissatisfied with the manager had no ability to remove any of the directors while the shareholders of the manager actually acted to not re-elect an independent director who was also the chairman of the Special Committee overseeing the internal investigations on the sponsor.

EXECUTIVE SUMMARY (CONT'D)

- Independent directors

The regulations under both the Securities and Futures Act (SFA) and Business Trust Act (BTA) for REITs and business trusts specify a list of criteria for determining independence, but allows the board to determine that a director is still independent even if those criteria apply. While independence is about independence in conduct, character and judgement and a case can be made for giving the board the discretion to assess a director to be independent notwithstanding the existence of certain relationships, it also makes the determination of independence somewhat nebulous. We have observed that it is not uncommon for trusts to use this flexibility given by the regulations. For GIFT 2020, we re-designated 14 directors serving on 11 trusts from independent to non-independent, usually for consulting or advisory work, or tenure exceeding nine years.

On the tenure of independent directors, the REIT and business trust sectors diverge. For REITs, when an independent director reaches a tenure of nine years, he or she is replaced. However, for business trusts, when independent directors reach nine years, the business trusts often justify that the long tenured directors are still independent and retain them. This difference is attributable to the differences in the rules, as the regulations for REITs under the SFA have been updated with a hard limit for tenure, while the regulations for BTs have not. It may be timely to update the BT regulations to align with those for REITs.

We are stricter this year in assessing independence because we took the view that higher standards than listed companies should apply to trusts, since unitholders are unable to appoint or remove directors, and are rarely given the opportunity to endorse them. The increased level of M&A activities also warrants that truly independent "independent directors" are appointed to boards to safeguard the interests of unitholders.

A REIT recently published an "addendum" to the 2019 annual report almost half a year later, providing information not previously disclosed that was required under the Securities and Futures (Licensing and Conduct of Business) Regulations. Even though it was clear that the said director had a deemed business relationship with the manager under Regulation 13G(2)(b), the two-person nominating committee redesignated the director from non-independent to independent.

We re-designated 14 directors in 11 trusts from independent to non-independent, usually for consulting or advisory work, deep business relationships, multiple relationships with the sponsor and its associated companies or for tenure exceeding nine years. In addition, demerit points were applied for independent directors in 23 trusts due to other factors such as other relationships with the sponsor or controlling unitholder and serving on three or more listed boards while holding an executive (full time) position.

EXECUTIVE SUMMARY (CONT'D)

We have also observed independent directors making lateral moves to related trusts once they hit the 9-year tenure on the board of a REIT. For example, an independent director served nine full years on the board of a logistics trust and then moved to the industrial trust of the same group again as independent director, after four months of "cooling off". Another director was on a different logistics trust for nine full years before resigning as independent director in March 2019 and promptly joined the board of a new hospitality trust belonging to the same group in May 2019. In our view, such practices undermine the spirit of the rules which put a hard limit on the tenure of independent directors for REITs.

There are also questions relating to whether independent directors of some trusts are selected for their competencies. Trusts should better explain why they appoint independent directors without relevant experience such as former civil servants, diplomats or politicians, and how they see such directors contributing to board effectiveness.

There is also scope for improving diversity of boards in terms of gender, ethnicity and age.

- Nominating and remuneration committees

The percentage of trusts with a nominating committee (NC) and remuneration committee (RC) - or a combined NRC - has fallen. This was partly due to the dissolution of two NRCs after a merger of two property groups, and the delisting of another three trusts with NRCs. For the former, unitholders may wonder if the boards of the REIT manager and BT trustee-manager made their own independent decisions based on their own circumstances and decided to dissolve the NRC soon after the parent group was bought over. While regulations allow the board to perform the duties of the NRC, we think it is a better practice to have an NC and RC, or a combined NRC.

- Quarterly reporting and distributions

Only twelve trusts earned the maximum points for continuing with quarterly reporting, either by the trusts explicitly stating so or by the trusts carrying on with their quarterly reporting with no cessation announcements made. Two of them continued with quarterly reporting as they are in the midst of a merger and will review after the merger.

Out of the remaining 33 trusts that have stopped quarterly reporting, 12 trusts have given assurance to unitholders that they will be providing an interim quarterly update for the first and third quarters. They were each given a point. The remaining 21 trusts gave a boilerplate statement that they will "continue to keep unitholders updated on material developments, as and when appropriate, in accordance with requirements of the Listing Rules". These trusts did not receive any points for quarterly reporting.

EXECUTIVE SUMMARY (CONT'D)

The removal of quarterly reporting has affected how frequently trusts make distributions to unitholders. At least nine trusts have stated that they will change from a quarterly to a half-yearly distribution following the cessation of quarterly reporting. Twenty trusts were already making half-yearly distributions before the change in quarterly reporting.

Five trusts appeared to have made the decision to stop quarterly reporting but to continue with quarterly distributions.

- Disclosure of remuneration

While the disclosure of NED remuneration has improved, we see no progress in the disclosure of remuneration of executive directors and CEOs. Only three trusts disclosed the exact remuneration of the CEO – Far East Hospitality, Hutchinson Port and Netlink NBN – and only four trusts disclosed the remuneration of top five KMPs in bands of no more than 250k together with the breakdown. Ten other trusts disclosed for less than top five KMPs.

MAS had provided guidance to REITs clarifying that any justification stating that remuneration is payable out of the assets of the REIT manager and not out of the deposited property of the REIT would not be considered a satisfactory explanation for not disclosing remuneration of the CEO, each individual directors and at least its top 5 executive officers on a named basis whether in exact quantum or in bands of S$250,000. However, we found that REITs frequently used this explanation.

- Alignment of interest

We assessed the alignment of interest between the manager and unitholders by looking at the fees paid to the manager relative to the DPU. Disappointingly, a third of the managers (15) collected higher fees while delivering lower DPU for unitholders. Another 40% (18) had their fees increased faster than DPU increased or decreased slower than DPU decreased. Only twelve trusts avoided the demerit points for this.

- Timing of AGM

A third of the trusts held their meetings on days which we consider as peak days (last five business days of the month) in this year's study compared to just 28% last year.

EXECUTIVE SUMMARY (CONT'D)

Business risks

In the business risk section, the average leverage has crept up slightly from 34.9% to 35.7% although REITs now have greater headroom with MAS allowing an increase in the aggregate leverage limit to 50% which became effective in April 2020.

Trusts also have greater interest rate risks on average, with a lower proportion opting to fix at least 70% their interest rates for their borrowings.

While REITs have promptly published their interest coverage ratios (ICRs), only three BTs disclosed their ICRs because it is not mandatory for them to do so. Under the BTA, business trusts have no mandatory limit on aggregate leverage and their cash flows can be less certain compared to REITs due to their business model. Therefore business trusts, in theory, face higher liquidity and insolvency risks. Logically, BTs should also disclose their debt-servicing ability, as measured by ICR, to unitholders. However, since the amendments were made only to the regulations for REITs and not for BTs, many BTs chose not to disclose the ICR.

The weighted average lease expiry (or WALE) is one area in which trusts have performed less well. Last year, approximately two-fifths of the trusts increased the WALE or have a WALE by gross rental income (GRI) greater than five years. This year, it dropped to just under a third. The percentage of trusts maintaining their WALE also dropped from 30% to 18%. We believe that the change in assessment using WALE by GRI partly contributed to the drop but this also reflects the challenges and uncertainty brought about by the pandemic.

We also observed greater use of perpetual securities as a source of funding – 31% of the trusts used hybrid securities this year compared to 26% last year. To be clear, perpetual securities are legitimate sources of funding for trusts. Our concern is the accounting treatment of perpetual securities which could be used by trusts to get around the limit for aggregate leverage, making trusts appearing financially safer than they actually are.

A cautionary note

It is important to recognise that governance and business risks are dynamic and could change, even for top-ranked trusts. Recent events after the cut-off date for GIFT 2020 would have altered certain aspects of the risk profile of some trusts and impact their scores based on these events. Netlink NBN Trust amended its trust deed to expand its investment mandate to include infrastructure business outside of Singapore following unitholders' approval at the AGM. Mapletree North Asia Commercial Trust announced an expansion of its investment mandate to include South Korea followed by a proposed acquisition of over $500 million in South Korea a minute later. Suntec REIT is proposing an acquisition in London (first foray into UK) which would bring its aggregate leverage ratio to 45.2% while its last reported ICR is at the lower end for REITs.

Governance Index For Trusts – October 2020

Ranking	REIT/BT	Governance risk Score	Business risk Score	GIFT 2020
1	NetLink NBN Trust	71	19	90
2	Keppel DC REIT	57	18.5	75.5
3	AIMS APAC REIT	53	22	75
4	CapitaLand Commercial Trust	52	22	74
	Manulife US REIT	54	20	74
	Mapletree North Asia Commercial Trust	56.5	17.5	74
7	CapitaLand Mall Trust	52.5	21	73.5
	Far East Hospitality Trust	56.5	17	73.5
	Parkway Life REIT	52.5	21	73.5
10	Cromwell European REIT	55	18	73
	Keppel Pacific Oak US REIT	51	22	73
	Prime US REIT	51	22	73
13	Mapletree Industrial Trust	48	24	72
14	Mapletree Commercial Trust	48	23	71
15	Keppel REIT	58	12.5	70.5
16	Soilbuild Business Space REIT	56	13.5	69.5
17	Ascendas REIT	51.5	17	68.5
	Frasers Centrepoint Trust	48.5	20	68.5
19	IREIT Global	49	19	68
20	Frasers Logistics & Commercial Trust	46.5	20.5	67
21	Mapletree Logistics Trust	47.5	19	66.5
22	Ascendas India Trust	47.5	18.5	66
	BHG Retail REIT	51	15	66
24	ARA US Hospitality Trust	48.5	15	63.5
	CDL Hospitality Trusts	45	18.5	63.5
26	First Ship Lease Trust	49.5	13	62.5
	Keppel Infrastructure Trust	50.5	12	62.5
28	CapitaLand Retail China Trust	45.5	16	61.5
	ESR-REIT	44.5	17	61.5
30	Starhill Global REIT	42	19	61
	SPH REIT	47.5	13.5	61
32	Frasers Hospitality Trust	43	17.5	60.5
	Sabana REIT	45.5	15	60.5
34	Sasseur REIT	43.5	16.5	60
35	Ascott Residence Trust	43	16.5	59.5
36	ARA LOGOS Logistics Trust	44	12.5	56.5
37	EC World REIT	43.5	12	55.5
	Suntec REIT	43.5	12	55.5
39	OUE Commercial REIT	42	12.5	54.5
40	Asian Pay Television Trust	41	9.5	50.5
	First REIT	37	13.5	50.5
42	Lippo Malls Indonesia Retail Trust	46	1.5	47.5
43	Accordia Golf Trust	32	13.5	45.5
44	Dasin Retail Trust	34	11	45
45	Hutchison Port Holdings Trust	34	5	39

EXECUTIVE SUMMARY – KEY FINDINGS

Section 1 - Board matters

- Six trusts give unitholders the right to endorse directors, including Starhill Global REIT that was a late addition
- Average board size remains at just over seven directors, the smallest having three and the largest 12 directors
- 49% or 22 trusts have an independent chairman

- Approximately half the trusts (22) have at least one independent director with both investment (including valuation) experience and experience in the sector, while eight did not have any independent directors assessed to have either relevant investment or industry experience
- There were 11 all-male boards, 16 mono-ethnicity boards, and 17 boards with only directors aged 50 years or older, with only 15 boards having all the three attributes of gender, ethnicity and age diversity
- There is a slight increase in trusts that do not have an NC or RC, or a combined NRC, with 12 not having an NC and 11 not having an RC
- 31 or 69% of audit committee (AC) chairs are assessed to have recent and relevant accounting/financial management experience
- In a third of the trusts, a majority of the independent AC members possessed recent and relevant accounting/financial management experience and expertise

EXECUTIVE SUMMARY – KEY FINDINGS

Section 2 - Remuneration matters

- 17 trusts disclosed the fee structure for non-executive directors (NEDs)
- 44 trusts fully disclosed the exact fees for each NED
- Only three trusts disclosed the exact remuneration of the CEO
- Four trusts disclosed the remuneration for KMP in bands of no more than $250,000 with breakdown into different components while 10 other trusts disclosed for less than 5 KMPs
- Two-thirds of the trusts include a long-term component in the remuneration packages of executive directors/senior management
- 14 trusts disclosed that they have put in place schemes which provide units or rights to units that vest over a minimum of three years
- 17 trusts did not disclose the KPIs used to determine the remuneration of executive directors/senior management, 19 disclosed return on equity and total unitholder return as KPIs, and nine disclosed DPU and NAV as KPIs

EXECUTIVE SUMMARY – KEY FINDINGS

Section 3 - Alignment of incentives and interests

- 19 trusts based performance fees on distribution per unit (DPU) which results in better alignment of interest with unitholders than net property income (NPI), up from 17 last year, with both newcomers doing so
- In a third of the trusts, management fees increased while DPU dropped and in another 40%, fees increased faster than DPU increased or fees decreased less than DPU decreased
- Two trusts had a unitholder who held a controlling stake selling down his units during March and April 2020 when there was significant market turbulence

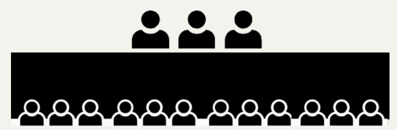
Section 4 - Internal and external audit

- Points were reduced from 10 to 5 in this area through removal of pure disclosure-type items, combining items and awarding fewer points for an unmodified opinion
- 22 trusts used an external independent service provider for their internal audit or have their own in-house internal audit function while the other 23 have an IA from the sponsor
- Two business trusts had “emphasis of matter” opinions issued by their external auditors in the previous year but there were none this year (EHT which received a disclaimer of opinion was not included in the study)
- One trust reported a material variance following the finalisation of audit

EXECUTIVE SUMMARY – KEY FINDINGS

Section 5 - Communication with unitholders

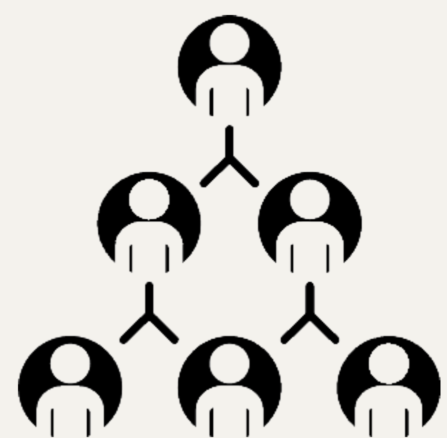
- Following the change to risk-based quarterly reporting, no trust was required to report quarterly
- 21 trusts changed to half-yearly reporting and did not commit to provide interim updates; 10 trusts continued as usual; 12 trusts changed to half yearly but committed to doing an interim update; and two trusts committed to doing quarterly reporting because of an ongoing merger



- All the trusts had the prospectus on their website but only three posted the trust deed
- 26 trusts provided the name of an IR contact person on their website, 14 directed unitholders to email the IR department; and five provided a contact form without a direct email
- 30 trusts avoided holding their AGMs during the peak period compared to 33 last year. In the last assessment, the peak period was the last five business days of April, July or October. This year, the peak period was extended to include the last five business days of May, June, August and September due to the COVID-19 measures for AGMs
- All except one trust posted their AGM slides and all but two posted their detailed minutes, although the improvement in the latter is mostly due to the COVID-19 measures for AGMs

EXECUTIVE SUMMARY – KEY FINDINGS

Section 6 - Other governance matters



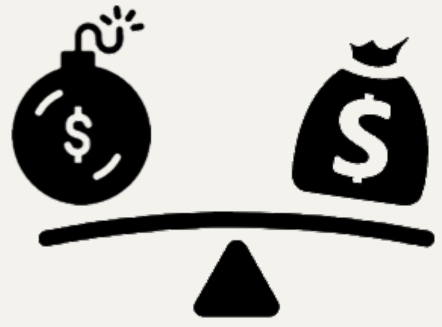
- 39 trusts had CEOs who had at least 10 years of relevant experience; based on the disclosure, we were not able to quantify the length of experience of the other six CEOs
- The CFO and CIO/Head of asset management roles are also held by qualified personnel although some business trusts did not have this position (or its equivalent)
- When CEOs were assessed for prior experience/track record if a trust ventures to a new geographical area, five CEOs were found to be lacking in experience in that new geographical area
- Similarly, 13 of the boards did not have any independent director with experience in the new geographical area
- Trusts which have diversified overseas have mostly diversified to countries with strong rule of law
- Six trusts received demerit points because the CEO, CFO or other key management of the manager or trustee-manager resigned without adequate disclosure of information regarding the circumstances, search for replacement and the expected time frame for a new appointment
- 18 trusts carried out private placements during the period under review, with some doing it more than once. Four trusts carried out dilutive private placements and received the full demerit points while the other 14 placed out at above the NAV per unit and did not receive demerit points
- Five trusts received demerit points as there were changes in the shareholding/control in the manager or the trustee-manager during the last two years

EXECUTIVE SUMMARY – KEY FINDINGS

Business risks

- Actual (non-weighted) leverage crept up from 34.9% to 35.7%; on a like-for-like basis, comparing trusts that were scored in both years, the leverage went up only marginally from 35.0% to 35.6%

- MAS has made it mandatory for REITs to disclose their leverage ratios and ICRs prior to 2022. From 2022 onwards, REITs must disclose their adjusted ICRs. This does not apply to BTs. Of the eight BTs, five did not disclose the ICR, with the other three BTs getting points for disclosing healthy interest cover ratios



- 26 out of the 32 REITs received points for ICR; one REIT disclosed a "profit cover" ratio instead of the required ICR

- All five stapled securities disclosed the ICR, with three getting points for disclosing healthy ICRs; a newly listed hospitality stapled group reported ICR of just 1.5 times

- Some trusts appear to have deviated from the definition of ICR that was given by MAS

- 22 out of 45 trusts had weighted average debt maturity of at least 3 years

- Based on the latest financial figures for 3 months/6 months as of June 2020, 35 out of 45 trusts had no more than 25% of debt maturing in the next 12 months

- 31 out of the 45 trusts had more than 70% of their borrowing costs fixed (including swapped to fixed rates)

- Eight trusts scored the maximum for foreign currency risks mostly due to them not having more than 30% in foreign assets earning foreign currency

- As we indicated last year, we have finetuned the assessment of weighted average lease expiry (WALE) to focus on WALE by gross rental income (GRI) as WALE by net lettable area (NLA) does not reflect the true risks to unitholders. In previous editions of GIFT, trusts could earn the maximum points if they disclosed a WALE by NLA that was in a healthy range. This year, if the trust only discloses WALE by NLA, they would not be able to score the maximum points

- Trusts with WALE increasing, greater than 5 years or remaining constant are awarded points, while those with WALE of less than 2.5 years and decreasing are given demerit points. Overall, 12 trusts received the maximum points for having a higher WALE or for WALE by GRI of at least 5 years; three trusts received demerit points for having a lower WALE that was less than 2.5 years

- 31 trusts obtained two merit points for not having hybrid securities. 14 trusts have hybrid securities (usually perpetual securities) although we note that more trusts have issued hybrid securities in August and September 2020 after the cut-off date of our study. One trust received additional demerit points as the distribution to perpetual security holders was higher than 25% of the distribution to unitholders

GOVERNANCE INDEX FOR TRUSTS (GIFT)[1]

October 2020

FULL REPORT

[1] The Governance Index for Trusts – GIFT – is produced by Associate Professor Mak Yuen Teen and Chew Yi Hong, in collaboration with governanceforstakeholders.com. The following individuals contributed to the development of GIFT: Alethea Teng Shuyi, Au Mei Lin Eunice, Wu Wenjing and Yap Hui Lin. No part of the GIFT methodology may be reproduced without the prior written permission of Associate Professor Mak Yuen Teen.

1. INTRODUCTION

As at 31 July 2020, there are 50 real estate investment trusts (REITs) and business trusts (BTs) with a primary listing trading on the Singapore Exchange (SGX), accounting for a total market capitalisation of $111 billion, lower than the $116 billion that we reported last year.

REITs and BTs have grown by more than 30 percent from $85 billion when we first started GIFT in 2017, a compounded average growth rate of over 9 percent. Considering the COVID-19 outbreak has affected every aspect of our daily lives, the sector has shown itself to be resilient, a credit to the strong regulatory framework put in place by MAS. The impact of COVID-19 on trusts depended greatly on the strength of their balance sheet and business model.

Of these 50 trusts, six are constituted as stapled securities (SS) (total market capitalisation of $6.2 billion), nine as pure business trusts ($11.1 billion) and 35 as REITs ($93.3 billion).

This fourth edition of the Governance Index for Trusts (GIFT) assesses the governance and business risk of 45 of these trusts. Two trusts are new to GIFT 2020, having more than a year of listing status to allow us to assess them meaningfully. They are Prime US REIT and ARA US Hospitality Trust. One cash trust (RHT Trust) was excluded, as were four newly-listed trusts, three with no published annual report (Elite, Lendlease and United Hampshire) and one (EHT) which was suspended and which published its annual report after our cut-off date.

GIFT remains the only published governance index in Singapore that specifically caters to listed REITs and BTs in Singapore. It assesses both governance and business risk factors.

Since 2018, we have also published separate scores for the governance and business risk areas. This recognises that while risk is important to investors, the level of risk to take is ultimately a business decision by the trust. Investors may be wise to pay particular attention to trusts that have higher risk and poorer governance.

[2] 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.

This year, the weighting for the governance factors was reduced from 80 percent to 75 percent of the base score by reducing the points for internal and external audit, while the weighting for the business risk factors was increased from 20 percent to 25 percent. In addition, some additional merit and demerit items are included. Minor adjustments were also made to how certain items are assessed, with a greater focus on substance compared to disclosure.

In 2018, we started the practice of inviting all the trusts that have published email addresses for their investor relations function to complete a self-assessment using the GIFT scorecard. This year, we provided trusts with the opportunity to complete the self-assessment online. We reviewed the self-assessment as part of our independent assessment, although our assessment may not necessarily be the same as the self-assessment provided by the trust. The self-assessment is completely voluntary and trusts that do not participate are not penalised.

Based on the participation in the self-assessment, the level of interest in GIFT amongst the trusts continues to be high. In 2018, 29 out of the 43 trusts (67%) we were able to contact by email submitted a self-assessment. In 2019, 34 out of 46 (74%) did so. For GIFT2020, 35 out of 45 trusts, or 78%, participated in the self-assessment. We would like to thank those who responded for engaging with us on this initiative and look forward to the continuing engagement from all the trusts listed on SGX.

We would also like acknowledge the support of the Singapore Exchange, and the recognition for GIFT given by MoneySense, the national financial education programme, for providing a link to GIFT to assist investors in assessing the corporate governance of REITs in their investment decisions.

2. METHODOLOGY

GIFT includes a main section carrying an overall score of 100 points. For this 2020 edition, 75 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 (5 points), communication with unitholders (15 points) and other governance matters (15 points).

Five points have been re-allocated from the governance section to business risk section, which now carries 25 points.

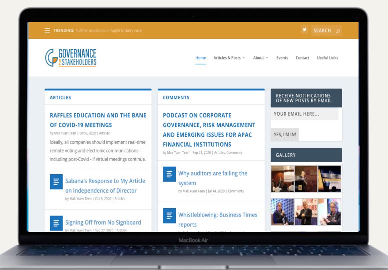
Business risk is assessed using leverage-related factors of overall leverage, debt maturity, percentage of fixed interest rate borrowing, and interest coverage ratio; and other factors relating to development limit, lease expiry, income support arrangements, and foreign assets and foreign currency risks.

The criteria and weighting for REITs and BTs are different in some areas 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 giving unitholders the right to propose directors for appointment and the manager/trustee-manager submitting itself for reappointment at regular intervals. Most merit points range from one to three points per item, with the exception of acquisition and divestment fees being charged on a cost-recovery basis/no such fees (five points). New merit items in GIFT 2020 are multi-dimensional diversity on the board and the frequency of board and board committee meetings. 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 having 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.



2. METHODOLOGY (CHANGE LOG)

Focussing on substance and raising the bar in GIFT 2020

The changes to the scoring framework, including new criteria, are due to changes in regulations such as cessation of quarterly reporting requirements, increase in aggregate leverage limit and COVID-related adjustments. Points have been reduced for disclosure-type criteria and also for the section on internal and external audit (reduction of five points). There are increases on weighting for alignment of interests criteria and business risk (with additional five points allocated to business risk section).

Section 1 - Board Matters (20 points)

- points given for directors with valuation experience

- (replacement merit item) two points if the board has multi-dimensional diversity

- (replacement merit item) two points if board held at least six board meetings, four AC meetings and two NRC meetings

- more stringent in assessment of directors' relationship with sponsors and related parties (leading to more demerit points for IDs); closer to adherence to independence criteria in the regulations under the SFA and BTA

- (new demerit item) if any director misses any (board and board committee) meetings in consecutive years and/or if any director misses two or more (board and board committee) meetings in a year

- (new demerit item) if no board committee meetings were held in the year

2. METHODOLOGY (CHANGE LOG) (CONT'D)

Section 2 - Remuneration of Directors and Key Management (10 points)

- new item on whether remuneration of EDs and/or CEO includes a long-term component (1.5 points)

Section 3 - Alignment of Incentives and Interests (10 points)

- points for disclosure of fees paid by trusts to REIT Manager, Trustee and Property Manager or the BT Trustee-Manager and Asset Manager reduced from four to three points

- KPI used for performance fee (increased from four to five points)

- finetuning how alignment between managers and unitholders is defined

- if fees increased while DPU decreased, three demerit points
- if fees increased faster than DPU increased or decreased slower than DPU decreased, one demerit point

Section 4 - Internal and External Audit (5 points)

- reduced from 10 points to five points through removal of disclosure-related items, combining items and awarding fewer points for unmodified opinion (with demerit points for modified opinions maintained) interactive live AGM/EGM

2. METHODOLOGY (CHANGE LOG)

Section 5 - Communication with Unitholders (15 points)

- points were reallocated to quarterly reporting under the new risk-based regime (two points)

- points for providing historical financial results, annual reports, updated website, URL were changed to demerit points for trusts that do not provide these

- "peak days" definition for AGM extended to last five business days for additional months to accommodate the automatic grant of 60-day delay in AGMs under COVID-19 measures

- meeting minutes are now required by SGX to be posted but points still awarded (no change)

- in lieu of meeting location and inviting unitholders to send in questions for the AGM, the two merit points were allocated to the cut-off timings for registration and Q&A to be less than 72 hours and 96 hours respectively

- (merit item) webcast of meeting now requires the trust to host an interactive live AGM/EGM

Section 6 - Other Governance Matters (15 points)

- (new demerit item) if the REIT/BT has overseas assets but EDs, CEO or the board has no prior experience in the region (one demerit point each for management and for board)

- (new demerit item) as an IPT, if the acquisition/disposal is less favourable than the average of two independent valuations in any interested person transactions and no appropriate reasons are provided (2 demerit points)

- (new demerit item) If the ED, CEO, CFO, CIO or CxO of the REIT Manager/BT Trustee-Manager resigns within 18 months of listing (3 demerit points)

- if REITs and BTs carry out a private placement at a premium to its last reported net asset value per unit, they will no longer receive demerit points; for trusts that carried out dilutive private placements, the demerit points remain at two

- (expanded demerit item) If there are inaccuracies or inconsistencies in the methodology used to recognise revenue or to calculate rental reversions, DPU, ICR and other performance indicators (two to five demerit points)

2. METHODOLOGY (CHANGE LOG) (CONT'D)

Business Risks (25 points)

- due to higher aggregate leverage allowed by MAS, trusts can score some partial points at the higher end of aggregate leverage of up to 50% (the new MAS leverage limit)

- (new criteria) three points for healthy interest coverage ratio of greater than 2.75 times

- points for debt maturity profile and debt tenure increased to a total of five (instead of four)

- additional (lower) thresholds were added for partial points (e.g. in debt maturity, debt profile, exposure to interest rate changes)

- Foreign currency risks (measured by foreign assets earning foreign currency) increased from two points to three points

- weightage for interest rate risks increased to three points from two (and partial points added)

- weighted average lease expiry (WALE) was assessed primarily using WALE by gross rental income (GRI); trusts that only disclose WALE by NLA can only score partial points

- WALE: demerit points were made less punitive (no demerit points if WALE decreased as long as WALE is still higher than 2.5 years)

- (new demerit item) if REITs and BTs expand to a new geographical area without a vote by unitholders (two demerit points)

- (new demerit item) REIT/BTs "diversify" into a new asset class to gain scale (e.g. a retail/hospitality REIT merging with a commercial REIT) and the unitholders' vote is less than 95% (two demerit points)

- (new demerit item) to safeguard against excessive use of hybrid securities, if the (annualised) interest on the hybrid securities is more than a quarter of its distributable income (two demerit points)

3. COVERAGE

Of the 45 trusts assessed, five are stapled. Of these, only one has a dormant business trust. The stapled securities were scored mostly as REITs but where relevant, the stricter standards for BT governance were applied to the stapled securities.

For information from annual reports, we used annual reports published between October 2019 and August 2020. The cut-off date for the data collection was extended to 31 August 2020. However, the AGMs covered were held from October 2019 to September 2020.

Figure 1 shows the distribution of market capitalisation for the 45 trusts assessed for GIFT 2020. There are 27 trusts in the billion-dollar club, down from 32 in 2019. Four are business trusts, two are stapled securities and 21 are REITs. Ascendas REIT, at approximately $13 billion, stands out as the only REIT with market capitalisation of over $10 billion.

Mapletree Logistics Trust and Mapletree Industrial Trust are the next two largest REITs at $8.1 billion and $7.7 billion respectively. Three other REITs have a market capitalisation of between $6 and $7 billion, with no other trusts above $5 billion.

Of the 18 remaining trusts in GIFT 2020, 14 have market capitalisation of more than $300 million to $1 billion. Four have market capitalisation of less than $300 million – two are business trusts, one is a newly-listed stapled trust and the other is a REIT.

In terms of the location of the assets, there are only seven Singapore-only trusts and another 15 with at least half of their assets located in Singapore. There are 14 other single-country trusts, with exposure to countries such as China, India, Indonesia, USA, and Japan. The remaining nine trusts have varying degrees of exposure to European countries, North Asia, Australia and USA.

Figure 1: Distribution of market capitalisation

4. KEY FINDINGS

For the main index (before considering merit and demerit points), the overall range of scores for the 45 trusts is from 39 to 80 out of a maximum of 100 points, with a mean of 66.8 and median of 69.5. While there is a decrease in the mean by 2.8 points, the median base score decreased by one point.

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

When merit and demerit points are included, the overall range of scores is from 39 to 90, with a mean of 64.3 and median of 66. The total score, including merit and demerit points, is a more complete measure of the governance and business risk of a trust. Compared to last year, the mean score fell by 3.7 points while the median fell by 2.25 points. The overall drop in score is mainly due to the raising of the bar and a greater focus on substance compared to disclosure.

Excluding the two new trusts, the overall average score for those trusts that were in both last year's and this latest edition decreased by 4 points, although we note that there have been significant changes to the scorecard between last year and this year, and in how certain items are assessed.

	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	5 points	15 points	15 points	25 points
Average score	10.4	3.9	6.9	4.5	12.1	13.0	15.8
Highest score	16	9	10	5	15	15	22
Lowest score	4	1	3	4	8	7.5	3

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

For the overall GIFT score, the top trusts for 2020 are NetLink NBN Trust, Keppel DC REIT, AIMS APAC REIT, CapitaLand Commercial Trust, Manulife US REIT and Mapletree North Asia Commercial Trust (last three tied in joint fourth) while the bottom six are Asian Pay Television Trust, First REIT (joint fifth), Lippo Malls Indonesia Retail Trust, Accordia Golf Trust, Dasin Retail Trust and Hutchison Port Holdings Trust. The top-ranked and bottom-ranked trusts are the same as 2019.

There are some changes in rankings compared to the previous year. We observe that there is some plateauing in the performance at the top of the ranking. Just two and a half points separate the second-placed trust and the tenth-placed trust. This clustering makes the change in ranking more significant than it actually is.

CapitaLand Commercial Trust (up from 10th to joint 4th), Parkway Life REIT (up from joint 18th to joint 7th), Cromwell European REIT (up from 17th to joint 10th), Frasers Centrepoint Trust (up from joint 27th to 17th) and IREIT Global REIT (up from joint 33rd to 18th) are some of the trusts in the top half of GIFT 2020 that had made good relative improvement in ranking.

Other trusts in the bottom half of GIFT 2020 that had good improvement in ranking include Keppel Infrastructure Trust and First Ship Lease Trust.

When we disaggregate the governance and business risk sections of GIFT, four trusts, listed in alphabetical order, were assessed as having both good governance and low business risk, being ranked in the top 10 on both factors. At the other end, six trusts were assessed as having relatively poorer governance and higher business risk, being in ranked in the bottom 10 on both factors.

Better governance and lower business risk
AIMS APAC REIT
CapitaLand Mall Trust
Manulife US REIT
Parkway Life REIT

Poorer governance and higher business risk
Asian Pay Television Trust
Dasin Retail Trust
EC World REIT
Hutchison Port Holdings Trust
OUE Commercial REIT
Suntec REIT

4. KEY FINDINGS (CONT'D)

Netlink NBN Trust does it again

Here are the reasons why Netlink NBN Trust retains its pole position in GIFT 2020.

- Allow unitholders to endorse directors
- Independent chairman
- Full disclosure on remuneration of NEDs and CEO
- Disclosure on remuneration of top 5 key management personnel in $250,000 bands
- ED/KMP remuneration based on total unitholder return (amongst other) and vests over three year period
- Minutes of meeting posted
- Low gearing
- No hybrid securities
- Internal trustee-manager so reduced misalignment with manager
- No income support
- No hybrid securities
- Reduced entrenchment risks as the largest unitholder holds less than 25% (and the trust is already internally managed)

4.1. Board matters

4.1.1. Appointment of directors

Six trusts gave unitholders the right to endorse directors of the manager - Keppel DC REIT, Keppel Infrastructure Trust, Keppel REIT, Netlink NBN Trust, Parkway Life REIT and Starhill Global REIT. This compares to five trusts for 2019. Where the manager commits to procure the resignation of directors who are not endorsed by unitholders, the unitholders' vote becomes effectively binding. No trust gave unitholders the right to elect directors.

Currently, no trust gives unitholders the right to nominate directors, rather than just endorse directors selected by the manager. Therefore, no trust received merit points for this criterion.

4.1.2. Board size

The average (mean) and median board size is seven directors, with a range from three to 12 directors. 71% of the 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 24 of the trusts only have 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 of the managers have a non-executive chairman. Twenty-three, or about half, stated that their chairman is an independent director (ID). We re-designate a chairman from independent to non-independent where he/she has significant relationships with the manager/trustee-manager or the sponsor (even where the nominating committee has deemed the director to be independent). This is because IDs should also be perceived to be independent.

4. KEY FINDINGS (CONT'D)

Relationships that we consider to be serious enough to cause a re-designation include significant consulting services (including legal services) provided by the director or his/her firm, or concurrent major appointments on the boards of a sponsor, controlling unitholder or other related entities. We do the same for all IDs on the board other than the chairman. In total, we re-designated 14 directors serving on the boards of 11 trusts, with one being the chairman of the board.

After the re-designation, 22 trusts have an independent board chairman.

4.1.4. Independent directors and competencies

For the percentage of IDs on the board, regulatory requirements applicable to REITs and BTs differ. Accordingly, we use different ranges for REITs and BTs in awarding points. For REITs, the ranges are: (a) below 50%, (b) at least 50% to below 75%, and (c) at least 75%. For BTs, they are: (a) at least 50% to below 75% and (b) at least 75%. Figure 2 shows the percentages of IDs for REITs and BTs (including stapled securities) respectively within each of these ranges, after the re-designation of IDs where applicable.

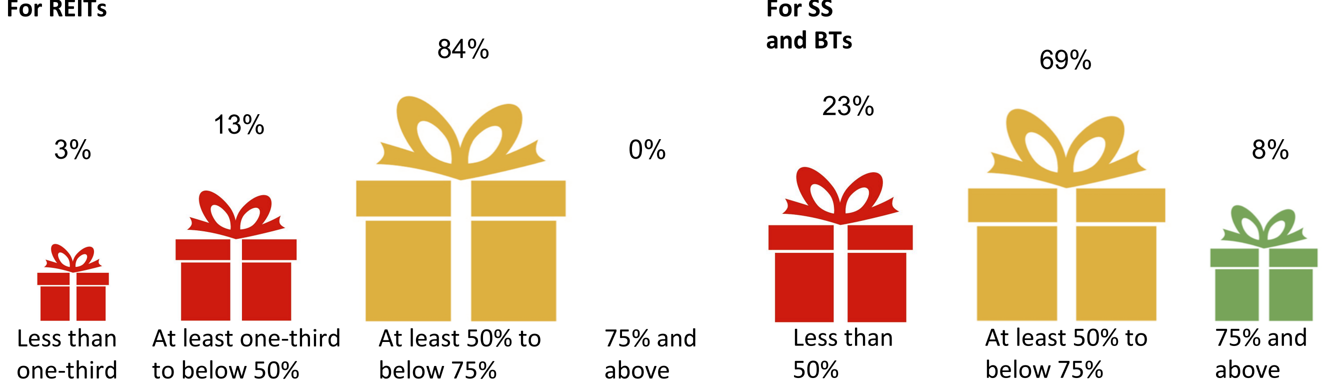


Figure 2: Percentage of Independent directors on the boards of REITs and BTs

In terms of competencies, IDs commonly have general business, banking, accounting and legal experience. For trusts, having IDs who have investment/fund management or valuation experience and prior working experience in the industry is useful. Twenty-one trusts have IDs with both types of experience while 16 trusts have IDs with either investment/valuation-related experience or industry experience. The remaining eight trusts did not have any IDs with either type of experience.

Twenty-two trusts attracted one to four demerit points for their IDs due to their association with the sponsor or controlling unitholder, or for serving on an excessive number of boards of listed companies or managers.

We also introduced a new merit item for board diversity, giving merit points for boards with at least one female director, more than one ethnicity, and with at least one director who is in their 40s or younger. Only 15 trusts have all these three board attributes and were given points. Three trusts had none of these attributes.

Figure 3 shows diversity attributes in the boards of REITs and BTs.

34 boards with both gender

29 boards with multiple ethnicities

28 boards with director(s) 40s or below

Figure 3: Dimensions of diversity on the boards of REITs and BTs

4. KEY FINDINGS (CONT'D)

4.1.5. Board committees

There is a decrease in number of trusts with a nominating committee (NC) or remuneration committee (RC), with 33 having an NC compared to 37 last year, and 34 having an RC compared to 38 last year. Following the merger of a property group with another, two NRCs were abolished under the new ownership, while one of the two new trusts does not have the NC nor RC. Nearly 70% (or 31 trusts) have a combined NC and RC. Trusts are given the same points whether they have separate NC and RC, or combined them.

Seven NCs and RCs have all IDs on the board committees.

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

Figure 4 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).

Figure 4: Composition of independent directors in the NC, RC and AC

Thirty-one (69%) of the trusts have an independent AC chair assessed to have recent and relevant accounting or related financial management expertise or experience, and a third of the trusts have a majority of IDs having such expertise or experience. We are stringent in assessing the AC members (including the chairman), 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. We are surprised that several ACs are chaired by lawyers who may not have relevant accounting or related financial management expertise or experience.

We introduced a new merit item for board and committee meetings, and a new demerit item for attendance at these meetings. Thirteen trusts which had more six or more board meetings, four or more AC meetings and two or more NC and RC meetings received two merit points.

Fourteen trusts received demerit points for 27 cases of a director who missed two or more board or board committee meetings in the latest financial year and/or did not have full attendance for each of the last two years.

4.2. Remuneration of directors and key management

Disclosures of remuneration relating to NEDs continued to improve, especially for disclosure of actual remuneration. Seventeen trusts, or 38%, disclosed the fee structure for NEDs compared to a third last year. For actual NED remuneration, 44 or 98% disclosed individual remuneration on a named basis, compared to 87% last year.

However, the same cannot be said for disclosure of remuneration of EDs and KMP. Only three trusts disclosed the exact remuneration of the CEO – Netlink NBN, Hutchison Port Holdings and Far East Hospitality – while only four trusts disclosed the remuneration of the top 5 KMP in bands of no more than $250,000, together with a breakdown into individual components. Ten other trusts disclosed for less than the top 5 KMPs.

4. KEY FINDINGS (CONT'D)

MAS had provided guidance to REITs clarifying that any justification stating that remuneration is payable out of the assets of the REIT manager and not out of the deposited property of the REIT would not be considered a satisfactory explanation for not disclosing remuneration of the CEO, each individual director and at least its top 5 executive officers on a named basis whether in exact quantum or in bands of S$250,000. However, we found that REITs frequently use this explanation.

On the performance measures used to determine the variable component of remuneration of KMP, 18 disclosed that they use return on equity (ROE) or total unitholder returns (TUR), and ten disclosed they used distribution per unit (DPU) or net asset value (NAV).

Thirty trusts included a long-term component in their remuneration framework. Of the 30, 18 disclosed the KPI used while 12 trusts did not disclose the KPIs used.

Fourteen trusts disclosed that they have schemes for their EDs/senior management which provided units or rights to units that vest over a minimum of three years.

Figure 5 shows the key remuneration disclosures and practices of the trusts for items in the main index.

Overall, there is considerable room for improvement in the disclosure of remuneration for EDs and senior management.

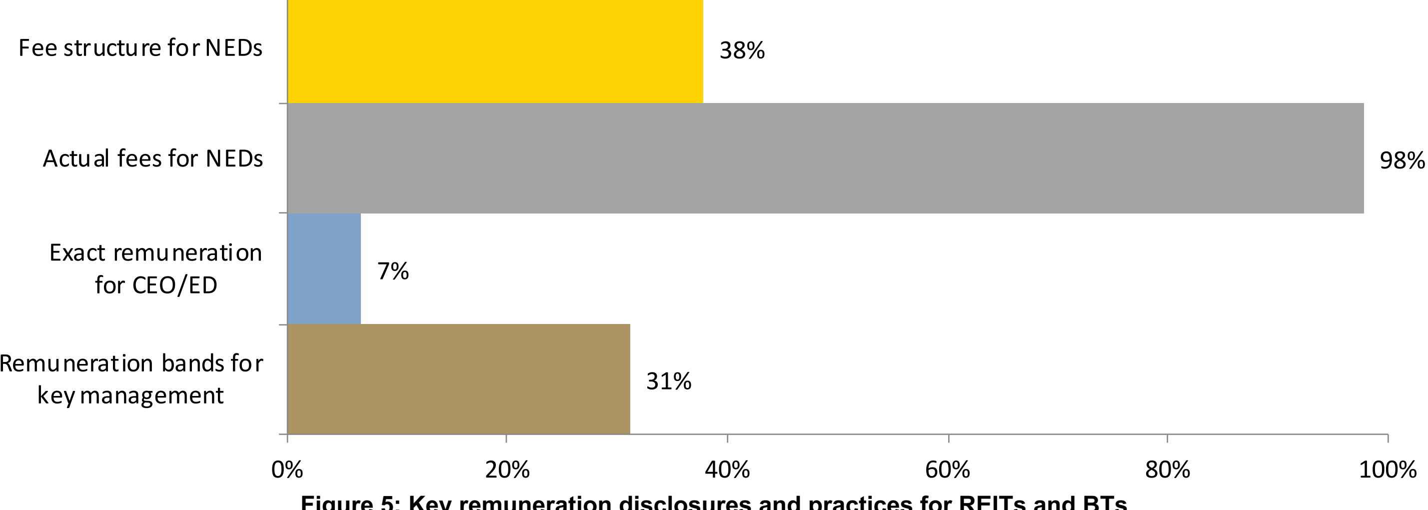


Figure 5: Key remuneration disclosures and practices for REITs and BTs

To help trusts better understand what we were looking for in terms of disclosure of the fee structure for non-executive directors, we have attached an example below.

Directors' Fees[1]

Directors' fees are reviewed and endorsed by the NRC. The framework for determining the Directors' fees is shown in the table below:–

Main Board	Chairman Director	S$50,000 per annum S$40,000 per annum
Audit Committee	Chairman Member	S$30,000 per annum S$15,000 per annum
Investment Committee	Chairman Member	S$20,000 per annum S$10,000 per annum
Nominating and Remuneration Committee	Chairman Member	S$20,000 per annum S$10,000 per annum
Operational Risk Management Committee	Chairman Member	S$10,000 per annum S$5,000 per annum

For a trust to earn two points for the disclosure on remuneration matters of executive directors and the CEO, the scoring guideline has used the term "fully disclose". By "fully disclose", we mean that the disclosure of remuneration should at most be rounded off to the nearest $1,000, with a breakdown into salary, annual bonus, long term incentives and other benefits.

4. KEY FINDINGS (CONT'D)

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.

Nineteen trusts use a unitholder return-type metric, DPU or NAV per unit to determine the performance fee of the manager, with DPU being the most common measure by far. We consider these measures to be better than income-type metrics such as net property income (NPI) because they better align the interest of the managers with unitholders. They are therefore given higher points in GIFT. However, 26 trusts link the performance fee to an income-type metric such as NPI, distributable income, gross profit and cash flow.

Disappointingly, for 15 trusts, fees paid to the manager/trustee-manager increased when DPU decreased. Another 40% (18) had their fees increased faster than DPU increased or decreased slower than DPU decreased. Only twelve trusts avoided the demerit points for this.

Three trusts did not disclose in the annual report how they compute the acquisition fee and divestment fee, including a business trust that received $10.7 million in such fee in FY2019. The trusts merely stated that the manager is “entitled under the Trust Deed” to receive such fees but the trust deed is not available online.

All the externally-managed trusts charge acquisition and divestment fees and none base these fees on a cost-recovery basis. One trust has a fee structure that entitles its manager to an acquisition fee of 1.5% for transactions of less than $200 million.

Four trusts, under the same property group, have a policy requiring their NEDs to hold some units at all times during his or her board tenure. Another trust recommends the NEDs to hold units of the business trust so as to better align the interests of directors with the interests of unitholders.

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 NPI as a performance measure, and adopting a policy requiring NEDs to hold some units until they leave the board.

Sinking deeper into the abyss

One trust did not mention whether it has a performance fee in the annual report presumably because it has not met the performance criterion to earn that fee.

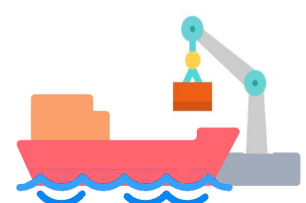
Based on its prospectus issued in 2011, the business trust set a high water mark for the performance fee which is based on DPU. On paper, the incentive scheme was well designed to motivate the trustee-manager to deliver better results for unitholders.

Unfortunately, since its listing in 2011, its DPU has been falling from approximately HKD0.51 for the first full year in 2012 to HKD0.11 in FY2019. Since the DPU threshold for the performance fee was set to be cumulative, if DPU was lower in Year 2, the trust had to make up the deficit in Year 3 before it gets any performance fee. However, since DPU has been constantly falling, the trust never met its DPU threshold to be eligible for any performance fee since it was listed.

We estimate that trust has to achieve a DPU of approximately HKD2 in 2020 to make up the shortfall. Based on the first half results, the trust may not even achieve a DPU of HKD0.08 in 2020.

While not re-setting the performance threshold can be argued to be fair to unitholders and can help mitigate "gaming" by the manager, it also means that the performance fee no longer serves its intended objective of motivating the manager to increase DPU as the threshold may no longer be achievable. In such a situation, we believe that the performance fee structure should be reviewed, possibly by re-setting the performance fee threshold in exchange for reducing the fixed management fee. However, any such changes should be clearly explained to unitholders.

In another REIT, the performance fee is based on the out-performance of the accumulated return of the REIT over the total return of the a benchmark index. Again, while the design of the incentive structure is well-intentioned, the performance fee no longer serves its intended objective of motivating the manager as the REIT's accumulated return was "approximately 139% and 83% below the Benchmark Index as at 30 June 2020 and 30 June 2019 respectively".



4. KEY FINDINGS (CONT'D)

4.4. Internal and external audit

This year, we reduced the number of points for internal and external audit from ten points to five points. We still think that the internal and external audit functions are important but we removed pure disclosure-type items, combined items and awarded fewer points for an unmodified opinion, while retaining the demerit points for modified opinions.

All trusts appointed mid-tier or Big 4 accounting firms. This year, no trust had unexplained changes in the external auditor or modified audit opinion (adverse, disclaimer, qualified) nor did any trust receive an emphasis of matter by the auditor relating to the trust's ability to continue as a going concern.

Similarly, the trusts did well in the area of internal audit. Approximately half of the trusts outsourced to a reputable external firm (Big 4, mid-tier or reputable risk consultancy firm) or have their own in-house internal audit function, and the other half outsourced to the internal audit department of the sponsor. Two trusts that did not identify the outsourced internal auditor and received fewer points.

Trusts should consider the possible conflict of interest and perceived independence of the internal audit when it is outsourced to the internal audit department of the sponsor.

The black sheep of the sector

Eagle Hospitality Trust, which had not published its annual report by the cut-off date for GIFT 2020, received a disclaimer of opinion in its 11-page Independent Auditors' Report for the financial period ended 31 December 2019. The basis for the disclaimer of opinion focused on the trust's going concern which is dependent on it receiving rental payments from the master lessees and the master lessees fulfilling their obligations under the master lease agreements. The master lessees are all indirect wholly-owned subsidiaries of the sponsors.

4.5. Communication with unitholders

As with previous years, communication with unitholders is another area that trusts often excel in. The change in the quarterly reporting regime and the COVID-19 measures for meetings have had some impact.

4.5.1. Timeliness of results

82% of the trusts released their latest annual results within 45 days.

However, with SGX moving to a risk-based quarterly reporting regime in February 2020, just before the results release for the January to March quarter, none of the trusts are required to report quarterly. Some trusts reported their quarterly results for the January to March quarter and announced that they will move to half-yearly reporting. At this point, we are unable to properly assess the quality of voluntary quarterly reporting or updates under the new regime.

One point is awarded to trusts that committed to an interim (operational/business) update at Q1 and Q3. Two points are given if the trust continues to provide unaudited financial statements every quarter. No points are awarded if trusts switch to a half-yearly reporting frequency and only stated that they will "provide relevant business updates between the announcements of half-yearly financial statements" as there is no certainty that they will do so.

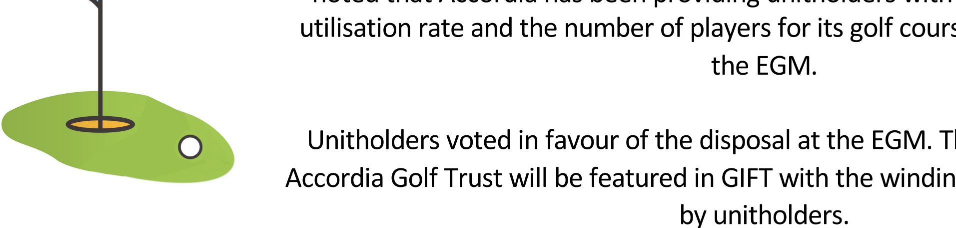
For this year, 21 trusts changed to half-yearly reporting and did not commit to provide interim updates. Twelve trusts changed to half-yearly reporting but committed to provide interim updates. Two trusts committed to continuing with quarterly reporting because of an ongoing merger but stated that it will review this again post-merger. These, and the remaining ten trusts, received two points each for reporting quarterly (with financial statements information).

An unfortunate consequence of trusts ceasing quarterly reporting is that it has affected how frequently they make distributions. Twenty trusts were already making half-yearly distributions prior to the cessation of quarterly reporting. Nine trusts will stop making quarterly distributions.

Playing fair on the golf course?

Accordia Golf Trust received a non-binding proposal for the purchase of all of its assets in November 2019, the details of which were not made public at that time. In June 2020, it released its full year results for the financial year ended 31 March 2020. Two weeks later, the trustee-manager announced that it would cease quarterly reporting and will instead announce financial statements on a half-yearly basis. As such, the next announcement would be for the period from 1 April to 30 September 2020. The trustee-manager assured unitholders that it will update them on any material developments relating to the trust as part of its continuing disclosure obligation.

Just four days after the announcement about the cessation of quarterly reporting, the trustee-manager announced the divestment proposal which would require a vote by unitholders. However, this meant that unitholders would have no visibility of the financial performance of the assets for the latest quarter when they vote on the disposal resolution, which was eventually scheduled for 14 September 2020.



Eventually, the trust published its financial update for the quarter three weeks before the EGM although it did not include the financial statements. It should be noted that Accordia has been providing unitholders with monthly reports of the utilisation rate and the number of players for its golf courses, even as it headed to the EGM.

Unitholders voted in favour of the disposal at the EGM. This is likely the last time Accordia Golf Trust will be featured in GIFT with the winding-up resolution approved by unitholders.

4.5.2. Accessibility of information and investor relations

All trusts have their IPO prospectus on the website but only three posted their trust deed – First Ship Lease Trust, Lippo Malls Indonesia Retail Trust and NetLink NBN Trust. We urge trusts to make their trust deed available on their website as it is an important document relevant for unitholders.

All the trusts provided information for contacting Investor Relations (IR), with 27 or 60% providing a specific IR contact person with contact details on the website and the rest providing either general contact details for an IR department or only an enquiry form to be filled up and submitted online.

To assess the responsiveness of the trust's IR, we contacted the trusts via email or by using the contact form. Trusts that had already responded to our invitation to submit a self-assessment were deemed to have met this criterion and were not contacted again. The response rate by the trusts' IR was 80%.

With 35 trusts submitting a voluntary self-assessment and a further eight responding to our email query, only two trusts did not meet the IR responsiveness test.

4.5.3. Unitholder meetings

Three quarters of the 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 statutory requirements of 14 days and 21 days respectively. However, this statistic is skewed this year due to the precautionary measures taken to stop the spread of the pandemic.

COVID-19 measures meant that AGMs this year were more spread out. Thirty trusts avoided holding the AGM in the last five working days of April to October 2020. SGX gave all issuers a 60-day automatic extension on the time to hold their AGM. All trusts should target to avoid the peak AGM periods to improve engagement with their unitholders.

4. KEY FINDINGS (CONT'D)

For the 40 trusts that held the AGM during the COVID-19 period, nine had a cut-off time for the submission of questions which was more than 96 hours before the AGM. The 96-hour cut-off was picked so that trusts can provide their responses to unitholders' queries before the cut-off for registration and proxy voting which was usually between 48 to 72 hours before the meeting.

The number of trusts posting minutes of meeting online on SGXNet or on the corporate website have increased multiple folds since we started GIFT in 2017, and for this year's assessment, only two trusts did not do so. However, the increase in trusts posting minutes this year may be due largely to the COVID-19 measures for AGMs introduced by SGX. The only two trusts that did not post detailed minutes held face-to-face AGMs before the COVID-19 measures were introduced.

Only one trust that held its AGM before the pandemic did not post its AGM presentation material online.

4.6. Other governance matters

4.6.1. Key management experience

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. Most trusts continue to have highly experienced management in these important roles. However, for five trusts, the disclosures were not sufficient for us to quantify the length of experience of the CEO.

4.6.2. Geographical experience of the boards and CEO

This year, we also assessed the experience of management and the board if the trusts ventured overseas. Trusts received one demerit point if the CEO did not have experience in the new geographical region that they expanded to. For example, a Singapore industrial REIT expanded to Australia, then USA and UK, with the overseas assets now accounting for 30% of the trust. While the CEO has deep experience and a good track record in Singapore, South East Asia and even Asia (South Korea), there is the question of experience in the new countries that the trust has expanded to and the value added by management. If the REIT is acquiring assets from the sponsor, there may be an imbalance of power and knowledge at the negotiation table.

	Chief Executive Officer	Chief Financial Officer	Head of Investment or Asset Management, or their equivalents
Experience of ten years or more	87%	93%	84%
Experience of between five to ten years	13%	7%	7%
Experience of below five years, no such appointment or insufficient disclosure	0%	0%	9%

Table 2: Experience of key management

4. KEY FINDINGS (CONT'D)

In such cases, the demerit points will cease after two years on the basis that the CEO has learnt on the job and acquired sufficient experience in the new market by then.

We also looked at the geographical experience of the boards for trusts with significant overseas assets and whether there are any IDs with experience in the new region. Where none of the IDs have such experience, we deducted one demerit point.

In total, 11% or five of the trusts received the demerit point for lack of experience for management and just over a quarter (12 trusts) received the demerit point for lack of experience for the board.

While we are not suggesting that trusts replace their CEO when they venture overseas, we do believe that there are challenges faced by the trust when such experience is absent which may impact unitholders. Nevertheless, as mentioned, we will remove the demerit point after two years. For IDs, we urge trusts to consider the relevant international experience on their boards when they expand overseas so that their boards can better oversee and support the trusts' overseas ambition.

4.6.3. Resignation of senior management

Six trusts received demerit points because the CEO, CFO or other C-suite executives of the manager/trustee-manager resigned without adequate disclosure of information regarding the circumstances, search for replacement and the expected time frame for a new appointment.

As a new demerit item, if the ED, CEO, CFO, CIO or other C-suite executive of the manager/trustee-manager resigns within 18 months of listing, the trust will get three demerit points. Three trusts received such demerit points. Curiously, all three cessations were the CFO of the trusts.

4.6.4. 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. Nine trusts were not awarded points as they solely or pre-dominantly operate in countries with weaker rule of law. Trusts were given partial points if they have some exposure to countries outside the top 25th percentile of the World Bank Governance Indicators.

4.6.5. AC review of interested person transactions

All the trusts disclosed that the AC reviews all interested person transactions (IPTs).

4.6.6. 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. The higher the percentage of units held by the 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 out of the 32 REITs, one out of five stapled securities and three out of eight BTs were assessed to have less entrenchment.

No trust currently subjects its manager to periodic re-appointment by unitholders which would earn the trust up to three merit points.

4.6.7. Stapling of REIT/BT

Stapling a trust with another trust further complicates the legal structure of the listed entity, changes its risk-return profile and reduces investor choice (who would prefer to purchase individual trusts on their own if they so wish). This is especially so if the trusts are in unrelated businesses. Only five of the trusts included in our assessment are stapled and four have an active trustee-manager stapled to the REIT in a related business.

4.6.8. 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.

4. KEY FINDINGS (CONT'D)

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.

In addition, we tracked the number of instances the trusts receive disclosure-related queries from SGX. Thirteen trusts were queried by SGX on its disclosure practices, such as clarification on deviation of CG practices. One trust received two queries related to its sale of assets.

4.6.9 Alignment of interests

In GIFT 2020, we have further finetuned the scoring to assess how trusts conduct their secondary fund-raising. As the trusts have grown larger, we have observed their preference for private placements. The commonly-given reasons are that private placements can be concluded very quickly and that the trust's exposure to institutional investors can be increased.

The other possible reason, which is unspoken, is that the sponsor/controlling unitholder does not have to come up with fresh capital but benefits from having a larger assets under management (AUM) and thus fees. Some sponsors hold as little as 10% of the units but benefit from 100% of the management and performance fees. Sponsors may carry out more placements as long as they feel that their control of the trust is not under threat.

In GIFT, we recognise that placements at above book value, in theory, is accretive although a renounceable rights issue, on paper, is the most equitable method to raise funds from the perspective of unitholders.

MAS has been clear that managers have to put unitholders' interests first. We wonder how much debate on the fund-raising method happens in the boardroom given that REIT managers and their directors have a legal obligation to act in the best interests of unitholders, and prioritise unitholders' interests over those of the REIT manager and its shareholders. We observed trusts carrying out a private placement and a preferential offering at the same time to fund their acquisitions. While the preferential offering was made non-renounceable, the price of its preferential offering was lower than the price for its private placement. While not perfect, this private placement-preferential offering combination, if executed well, mitigates some of the concerns of all the stakeholders as compared to carrying out private placement or a preferential offering solely.

Only four trusts received demerit points for carrying out dilutive private placement at prices below NAV per unit. No demerit points were given to the 14 other trusts that carried out private placements at above their NAV per unit.

Nine trusts carried out non-renounceable preferential offerings.

In recent years, there have been changes to the ownership of REIT managers and BT trustee-managers. Such changes may result in a shift in the trust's strategy, including growth plans and market focus, risk profile and board and key management personnel. Two trusts received demerit points for changes in the control of the manager in the past two years and three other trusts for forming or breaking partnerships at the manager level.

Two trusts have distributions that were artificially boosted due to the waivers of certain groups of investors/strategic unitholders to distributions made by the trusts, as they are unlikely to be sustainable.

Too big to worry about small things?

A REIT recently disclosed in its Q&A session that with its market capitalisation of over US$1.1 billion, it can raise close to US$220 million via a (non pro-rata) private placement of up to 20% of its total units. This quantum would allow the REIT to make meaningful acquisitions. The REIT stated, almost as a policy, that its preference for fund-raising would always be placement, preferential offering and lastly rights issue in that order.

To safeguard their interests, unitholders should be careful in voting for the resolution to authorise the manager to issue units in a non pro-rata manner.

4. KEY FINDINGS (CONT'D)

4.7. Business risk

In GIFT 2020, 25 points are allocated to factors related to business risk. These factors include: (a) leverage-related factors of overall leverage, interest coverage ratio, average debt maturity, percentage of debt maturing within 12 months and percentage of borrowings carrying fixed interest rates; (b) change in weighted average lease expiry (WALE) from prior year; (c) extent of income support arrangements; and (d) foreign assets and foreign currency risks.

For REIT, a fifth factor, percentage of development limit, was included, with the weightage for overall leverage reduced.

In April 2020, MAS introduced a new requirement for REITs to disclose the interest coverage ratio (ICR), following its decision to increase the leverage limt for REITs. We included the disclosure and range of ICR in the GIFT scorecard.

Figure 6 shows how the trusts fared in terms of the distribution of the level of leverage, interest coverage ratio, the weighted average debt expiry and the weighted average lease expiry.

Of the eight business trusts, five did not disclose the ICR as the MAS requirement only applies to REITs. However, BTs face similiar risks with regard to leverage and loan servicing ability. REITs and BTs that did not disclose their ICR did not receive any points.

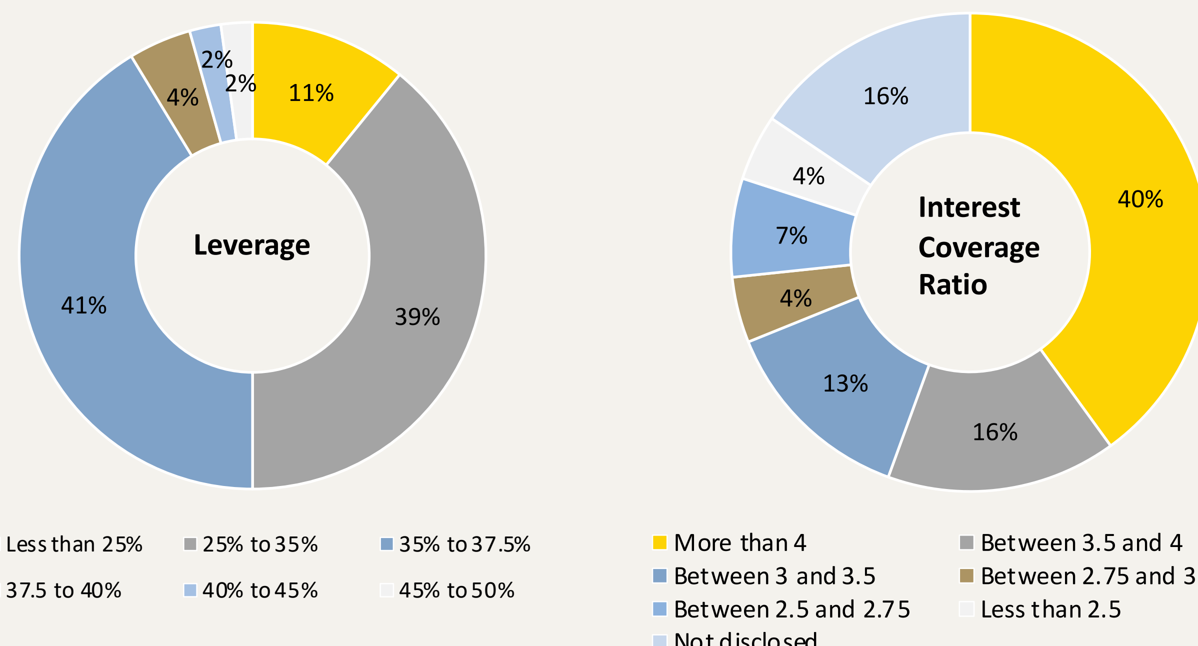


Figure 6: Distribution of the level of leverage, interest coverage ratio, the weighted average debt maturity and weighted average lease expiry

Three REITs and two stapled securities had ICR below 2.75, which is the minimum threshold in GIFT and therefore did not receive any points for ICR. Two other REITs did not receive any points for ICR because one had announced its half year results before the rule changed and has since ceased quarterly reporting while another reported profit cover, not interest cover, with a very different definition.

Debt maturity

About half (22) of the trusts have weighted average debt maturity of longer than three years and 13 of them have a weighted average debt maturity of between two and three years. Ten trusts have a weighted average debt maturity of less than two years.

Debt maturing in next 12 months

Based mostly on the latest available financial figures (three or six months results/update ending June 2020), 34 have less than a quarter of their borrowings maturing in the next 12 months. Three have between 25% and 30% of their loans maturing in the next 12 months and the six other trusts have more than 30% of their borrowings maturing in the next 12 months. Two BTs did not disclose sufficient details for us to make a clear assessment. We note that some trusts make use of a major loan facility which concentrates the refinancing risks in the years when the facility is due for refinancing. In one such case, as much as 77% of a trust's borrowing is due for renewal within 12 months.

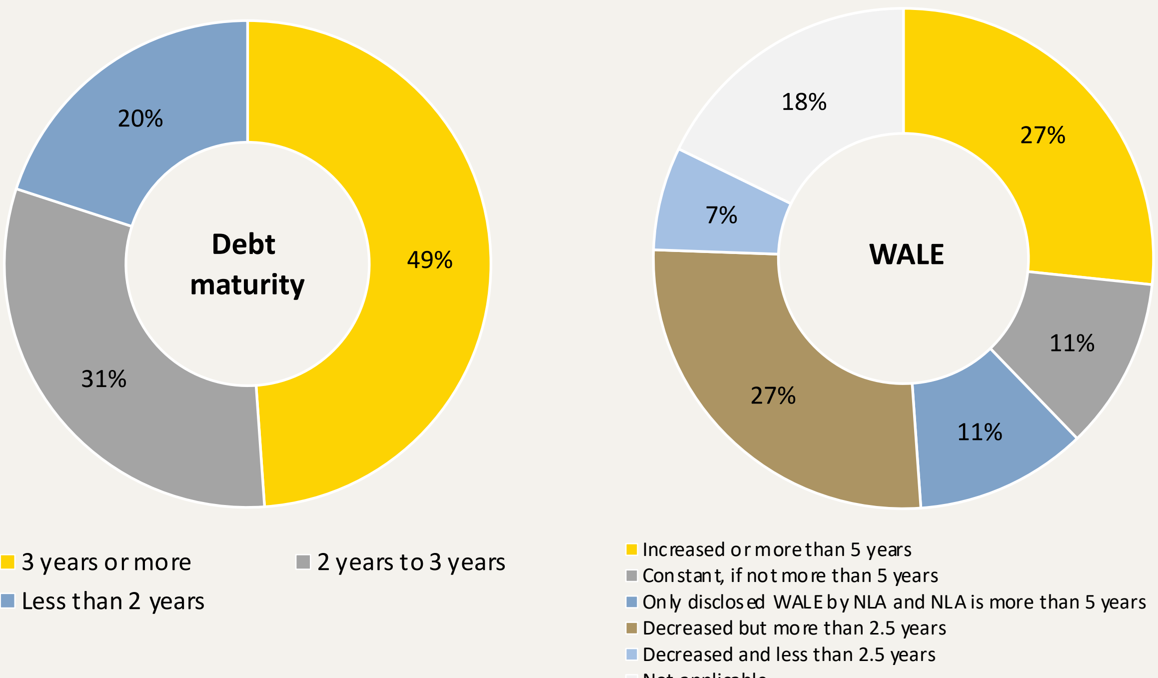


Figure 6: Distribution of the level of leverage, interest coverage ratio, the weighted average debt maturity and weighted average lease expiry

4. KEY FINDINGS (CONT'D)

Weighted average lease expiry

As we indicated last year, we have finetuned the assessment of weighted average lease expiry (WALE) to focus on WALE by gross rental income (GRI) as WALE by net lettable area (NLA) does not reflect the true risks to unitholders. In previous editions of GIFT, trusts could earn the maximum points if they disclosed WALE by NLA that was in a healthy range. This year, if the trust only discloses WALE by NLA, they would not be able to score the maximum points.

Trusts with WALE increasing, greater than 5 years or remaining constant are awarded points while those with decreasing WALE of less than 2.5 years are given demerit points. Overall, 12 trusts received the maximum points for having a higher WALE or if WALE by GRI was at least 5 years; three trusts received demerit points for having a lower WALE that was less than 2.5 years

Income support arrangements

About four-fifths of the trusts did not disclose any income support arrangements or disclosed that they did not have such arrangements. The other trusts have some form of income support arrangements, with two trusts having income support exceeding 10% of their total distributions.

Fixed interest rates

Thirty-two trusts have more than 70% of their borrowings carrying fixed or swapped to fixed interest rates and received the maximum points. Eight hedged at least 50% of their interest rate risks (but less than 70%) while the remaining five hedged less than 50% and received no points.

Foreign currency risks

Twenty trusts scored the points for having lower foreign currency risks, with eight of them scoring higher by having mostly Singapore assets. Ten trusts earned partial points if they had less than 30% in foreign assets earning foreign currency and substantially hedged their income. The remaining 26 exceeded the 30% threshold and received no points.

Development limit

For REIT, we include development limit as another factor related to business risk. REITs are allowed to exceed a 10% development unit with the approval of unitholders. A higher development unit exposes the REIT to higher risk. We have not observed any REIT seeking unitholders' approval to increase the development limit since the limit was raised.

4.7.1. Use of hybrid securities

The fact that, under current financial reporting standards, perpetual securities are classified as equity even though they have debt-like features, have made them attractive to certain issuers.

Starting from the first edition of GIFT, we have included a merit item relating to hybrid securities in the business risk section of the scorecard. Trusts that do not use hybrid securities, such as convertible or perpetual securities, are given two merit points. We decided to reward those that do not use hybrid securities as we felt that the use of such securities may understate the true business risk of a trust or make their business risk more difficult to assess.

Fourteen trusts have hybrid securities, usually perpetual securities. More trusts have issued new hybrid securities in August and September 2020 after the cut-off date of our study. Thirty-one trusts obtained two merit points for not using hybrid securities. One trust received further demerit points as the distribution to perpetual security holders was higher than 25% of the distribution to unitholders.

For perpetual securities, the distribution rate could be as low as 3.07% for Ascott Residence Trust (after the rate was reset in June 2020).

Typically, the distribution rate is reset after 5 years (although in some cases, the first reset is after 5.5 years), with an exception being Keppel Infrastructure Trust with a reset and step-up after 10 years.

Types of hybrid securities

Perpetual securities

- ARA LOGOS Logistics Trust
- Ascendas REIT
- Ascott Residence Trust
- ESR-REIT
- First REIT
- Frasers Hospitality Trusts
- Keppel REIT
- Lippo Malls Indonesia Retail Trust
- Mapletree Logistics Trust
- Soilbuild Business Space REIT
- SPH REIT
- Keppel Infrastructure Trust

Convertible bonds

- Suntec REIT
- OUE Commercial REIT (Convertible perpetual preferred units)

GIFT 2020 - REVIEW OF THE SECTOR

OCTOBER 2020

REVIEW OF THE SECTOR

A bumpier year

In last year's report, we said that the sector had a less eventful year with fewer controversies, and that certain trusts seemed to have put their worst behind them and shown large improvements in GIFT scores.

We are less sanguine this year and believe that the sector may be at a crossroad with regulators and investors having to be more vigilant. There were the problems with EHT which was suspended just ten months after listing before a single cent was distributed to unitholders. It is now undergoing both an internal forensic investigation and a regulatory investigation, with some directors being arrested although not charged at the time of writing this report. At EC World REIT, the Chief Investment Officer was subject to regulatory investigation and resigned although it may involve matters that are not related to the REIT.

Strategic reviews at Asian Pay TV Trust and Sabana REIT did not lead to much. The now-approved sale of assets and winding-down of Accordia Golf Trust and the proposed merger of ESR REIT and Sabana REIT have led to public outcry from minority unitholders, including a requisition for an EGM. These trusts were ranked in the bottom one-third of GIFT last year. Good governance is critical to gaining investors' trust and governance issues come to the fore particularly in situations such as privatisations and mergers where the interests of the managers, sponsors and controlling unitholders often diverge from minority unitholders. Good governance would put trusts in a better position when they have to execute corporate actions that may be contentious.

The sector has not been spared the impact of COVID-19. Distributions have been cut drastically. Issuers with weak tenants, weak sponsors, overleveraged balance sheet (especially with hospitality and retail assets) have been badly affected. Those with strong fundamentals, and to a certain extent strong sponsors, have recovered faster.

Increasing risk

When the REIT sector started, the focus was on stability and income/cash generation. In recent years, the emphasis in the sector has shifted to growth, which also increases risk.

Last year, we signalled that the sector is likely to become riskier as more foreign trusts list here and Singapore-based trusts with strong local sponsors venture overseas.

REVIEW OF THE SECTOR (CONT'D)

This was what we said:

> *"Before unitholders apply for units in a new listing, including foreign ones, in what seems to be assumed to be a "sure-win" REITs sector, they may want to ask themselves why certain foreign trusts are listing in Singapore especially when the sponsor is not local and the assets are overseas. For example, there are currently 185 REITs traded on the New York Stock Exchange, with total market capitalisation of US$1.104 trillion. According to REITAS, the total market capitalisation of REITs here is about S$100 billion. In other words, the REIT market in U.S. is much bigger, so the question is why are some REITs with U.S. assets seeking listing here rather than back home?*
>
> *Of course, this may reflect the success of MAS and SGX in making Singapore a major international listing destination for REITs. Today, REITs account for a larger percentage of total market capitalisation of SGX (10%) compared to other key markets such as Australia, Japan, U.K. and U.S., and Singapore is now the second largest REIT market in Asia after Japan. Nevertheless, we believe it is important for investors to understand what they are investing in under our largely disclosure-based caveat emptor regime."*

Our words turned out to be quite prescient especially given the problems at EHT. That being said, there are foreign trusts which have fared reasonably well in GIFT 2020, with one ranked joint fourth.

In last year's report, we highlighted changes in risk profile of local trusts as they venture overseas, and questioned whether they are operating outside their core competence and their network and knowledge of the local market. Deals overseas are likely to come from brokers, and a Singapore trust landing a deal in a foreign market will more likely than not mean that established investors in the local market have passed on the opportunity or the Singapore trust is willing to pay a higher price. Trusts acquiring assets from sponsors who are already established in these foreign market also face other conflicts. Further, even with financing in foreign currency and forward-hedging of expected distributions, these trusts still retain significant exposure to the foreign exchange risk. We see many examples of trusts venturing overseas.

There are several examples where the CEO and the board only have working experience in Singapore and the trust makes acquisitions in countries such as Australia, Europe, or USA.

REVIEW OF THE SECTOR (CONT'D)

We also see more trusts getting into "hot" themes such as data centres or expanding into lower tier cities to obtain higher yields. These will contribute to higher risks for certain trusts.

The over-reliance of certain trusts on the sponsor and master leasees (which are often controlled by the sponsor) also creates significant risks. Examples include EC World Reit, EHT Reit, First Reit, Lippo Mall and Sassuer Reit.

First aid needed?

First REIT is now facing uncertainty in its rental income as some of its master leases (previously priced in SGD) are expiring. The former sponsor – which owns the hospital operator that is the master leesse – has claimed that the existing rates are not sustainable.

The former sponsor issued a press release claiming that the existing rental rates were "unrealistic to sustain and support". Even before accounting for the impact of COVID-19, existing rental rates, on average, accounted for close to 40 per cent of the hospitals' gross operating revenue based on the press release.

Who has more bargaining power? Are the directors/manager prepared to search for a replacement hospital operator? Are there implications on the ground, such as the local government insisting that hospital operations cannot be disrupted? Will distributions fall drastically? Give that the hospital operator accounts for 85% of the trust's revenue in FY2019, will all the master leases be negotiated downwards?

The uncertainty around its leases have depressed the unit price to low-mid 40 cents. At the beginning of the year, the REIT traded at over a dollar per unit.

Consolidations and mergers

Consolidation has continued with three trusts being merged and no longer listed on SGX, with several other mergers that are in progress. These mergers often take some time to execute for reasons such as having to convene EGMs; changing the trust structure; changing the trust deed to allow certain investments or accommodate the new structure; needing approval from minority unitholders for interested person transactions; and delays due to COVID-19.

REVIEW OF THE SECTOR (CONT'D)

While there may be valid reasons for certain mergers, investor choices become more limited even as the sector is growing, as trusts merge across segments - such as commercial and industrial, or retail and commercial. From the managers' and sponsors' point of view, such mergers may enable them to better diversify their risks. However, it also means investors lose the choice of investing in "pure play" trusts, such as selling or avoiding hospitality trusts and buying commercial trusts.

Unitholders are asked to foot the "acquisition" fee for the "merger" upfront, even if the assets acquired come from a related trust. More importantly, unitholders need to question if there are real operational synergies that would translate into tangible benefits for them. On paper, merging a hospitality trust with a commercial real estate trust can be justified by various textbook reasons. Ultimately, it is up to the manager to execute well based on a good strategy to deliver returns to unitholders.

Privatisations and mergers have proven to be highly contentious in some cases, notable examples being the ones involving Accordia Golf Trust (effectively sale of assets and winding down of the BT) and ESR REIT/Sabana REIT.

As long as a trust is externally managed, issues of alignment of interests between unitholders and the manager are likely to arise, given that the manager has its own financial considerations and ultimately accounts to a different set of shareholders (which are not the unitholders of the listed trust).

Misalignment of interests between sponsors, managers and unitholders

There are many instances where the interests of the sponsors, managers and unitholders are not aligned, even if legally, the managers and their directors are required to prioritise the interests of unitholders ahead of the managers and the sponsors. Especially for managers using an income-type metric such as NPI as the measure for performance fees, any acquisition that increases NPI will increase fees paid to the manager. However, higher NPI may not mean higher DPU for unitholders. Further, if financed by private placements, perpetual securities and bank loans and borrowings, the sponsor does not come up with new capital but is assured of higher earnings in the form of higher fees. Given the current low interest rate environment, marginal acquisitions become viable. If and when interest rates creep up, there will be significant pressure on the capacity of the trusts to maintain or increase DPU.

In addition, there are often changes to shareholding in the manager which may not be in the interest of unitholders. The financial details of such changes are often not disclosed to the market. Incentives are not aligned with unitholders as the "investor" in the manager would expect a reasonable return on investment for the price paid for the manager.

REVIEW OF THE SECTOR (CONT'D)

One REIT in fact emphasised that the success of the manager, not the trust, is the focus. It said:

> "In deciding on the remuneration of directors and key executive officers, the NRC will consider the level of remuneration that is appropriate to attract, retain and motivate the directors and key executive officers to run the **Manager** successfully. The NRC will, in setting the remuneration packages, take into account the pay and employment conditions within the industry and in comparable companies, the **Manager's** relative performance and the performance of the key executive officers….The Manager adopts a remuneration policy for staff comprising a fixed component, a variable component, and benefits-in-kind. The fixed component is in the form of a base salary. The variable component is in the form of a variable bonus that is linked to the **Manager's** and each individual employee's performance." [emphasis added]

Another example of misalignment of interest is where private placement is chosen as the default for secondary fund-raising. With a market capitalisation of approximately US$1.1 billion, a 20% placement allowed one trust to raise close to US$220 million. It stated that its preference would always be ***placement, preferential offering and lastly rights issue in that order***. The reason given was that rights issues carry the largest discount, causing huge dilution and exposing the trust to market volatility and price movement for an extended period. While it is true that a rights issue may incur the largest discount, from the perspective of unitholders, it has no impact given that a rights issue can be made renounceable and unitholders are then given the option to sell the rights or to subscribe for the rights. This is in the best interest of unitholders, which the manager/board have a fiduciary duty to ensure. There might be valid reasons to carry out private placements to fund its acquisitions but it is the duty of the board to deliberate on all its available options, keeping in mind their fiduciary duty. To have a firm policy that a private placement is always preferred may make unitholders think that the board is not acting in the unitholders' interest.

Similarly, any manager that carries out a placement below NAV to fund acquisitions has to be able to justify the transaction with a thorough examination of the numbers. In placing out new units at below NAV, the manager is taking away value from existing unitholders and offering the current assets at a discount to the placee. Whatever return generated from the newly acquired asset would be over-stated for existing unitholders as they have to give up a share of the orginal portfolio. A private placement at below NAV may make sense if the manager knows that the value of the existing portfolio is overstated in the books and it is optimal to trade a share of its existing portfolio for new and hopefully better assets. In nearly all cases, the manager would stand to earn higher fees with a larger AUM.

REVIEW OF THE SECTOR (CONT'D)

Good risk-reward for who? Manager or unitholders?

A REIT increased its AUM by 20% or $637 million, acquiring a 50% stake in a foreign mall which was partially funded by the issuance of perpetual securities three months earlier. On a pro-forma basis, the impact on DPU was minimal, increasing from 5.6 cents to 5.69 cents.

While DPU accretion was estimated at just 1.6%, the manager was paid a $6.4 million acquisition fee, with professional fees and other expenses adding up to another $8.3 million.

It relied on a third party manager so there may be double layer of management fees involved, one paid to the third party manager and the other to the REIT manager.

The management fee increased from $4.47 million in Q2 2019 to $5.5 million in Q2 2020 although there appears to be limited avenues for the manager to value-add to the newly acquired asset since the manager is new to the city and relatively new to the country, having acquired a smaller asset in another state a year ago.

When a trust buys non-controlling stakes in properties or portfolios of assets, it must raise the question of the value-add by the manager. Not only is the trust acting like a financial investor with no ability to value-add to the assets, there could be multiple layers of fees involved for unitholders. Since it is not a majority stake, the REIT manager has no control over operational matters and depends on third parties to manage the day-to-day operations, including the leasing and the asset enhancement. It pays management fees and performance fees on these assets to external parties, and then charges a base fee, and even performance fees, on the income generated from these assets to unitholders of the listed REIT. Depending on how the asset or portfolio is structured, there may be tax implications and income from these assets could be taxed before reaching the REIT, defeating the purpose of unitholders investing in a REIT.

Cherry-picking metrics

Underperforming trusts often highlight that they continue to distribute 100% of distributable income when their actual distribution per unit has fallen considerably. For example, at one trust, the 100% distributable income was emphasised but the actual distribution per unit has actually fallen by 80% in seven years.

REVIEW OF THE SECTOR (CONT'D)

An underperforming trust may also choose to highlight its yield. A business trust in the port business that was first listed in 2011 started emphasising its yield from 2013 even as the unit price and distribution fell every year. The "attractiveness" of the investment at the current "distribution yield" was highlighted, with little comment about the fall in distribution and unit price. Investors should be wary of trusts that only emphasise the "distribution yield".

Regulatory reforms

In April 2020, MAS increased the aggregate leverage limit for REITs to 50%. REITs are also required to disclose their interest coverage ratio (ICR). When the ICR threshold of 2.5 times takes effect on 1 January 2022, REITs will also be required to compute their ICR by including distributions on hybrid securities in the denominator ("Adjusted ICR"). This approach takes into account feedback received during the public consultation that distributions on hybrid securities are similar to interest expense as they are financial obligations that REITs have to satisfy. From 1 January 2022, REITs will also be required to disclose the Adjusted ICR, in addition to the ICR, in their interim financial results announcements and annual reports. The threshold of 2.5 times will only be applied on the adjusted ICR on a trailing 12 months basis.

However, who will monitor this? Already we see trusts having different treatments for lease liabilities, upfront fees, non-recurring finance expenses, tax expense, fair value of derivatives and interest income. In particular, while MAS has stated that ICR should be calculated on a trailing 12 months basis and that interest income would be excluded from both EBITDA and interest expense, a REIT just disclosed in July that it has a ICR of 3.6 times that was computed based on 2Q FY2020 earnings and that the denominator had included interest income (which inflates the ICR).

We also note that the Business Trust Act and Regulations have not been updated compared to the regulatory requirements for REITs. For example, business trusts (including stapled securities) still have to send CDs to unitholders, while REITs are not required to. The "nine-year" rule is adhered to strictly for IDs by REITs, but business trusts continue to retain IDs beyond nine years by explaining that the board still believes the ID to be independent.

We also believe that the ability of the board to deem a director of a REIT or business trust to be still independent, even when the director has one or more of the relationships specified in the regulations, undermines the effectiveness of the regulations. With unitholders at best only having a right to endorse the directors of the managers and trustee managers, and no ability to appoint directors, it is already difficult for directors to be truly independent and to be perceived to be so. In the past year, certain privatisations and mergers have raised questions about the independence of IDs. We recommend that this area be reviewed for both REITs and business trusts. Consideration should be given to requiring trusts to seek unitholders' endorsement of IDs in such situations.

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Prof Mak developed the Governance and Transparency Index (GTI) and was the Singapore expert involved in developing the ASEAN Corporate Governance Scorecard. He also edits an annual collection of case studies published by CPA Australia and publishes regular reports on corporate governance-related topics. Prof Mak also conducts corporate governance training for directors, regulators and other professionals in the region.

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