Problem Solving and Investment Suggestions of China's REITs Development

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Abstract: The real estate industry has an important position in the national economy. In recent years, with the increasing growth of the real estate economy, the real estate financing model, which is mainly based on traditional bank loans, has started to gradually accept REITs (Real Estate Investment Trusts), and REITs have begun to develop in the Chinese market. This paper analyses the current situation, history, investment targets, and structure of China's REITs market in the context of both risks and opportunities, combines the performance of the market with the problems and solutions arising from the development of REITs, and provides constructive investment advice to investors. This paper indicates that although the scale of China's REITs market is relatively small and the product structure still needs to be optimized, with the continuous growth of China's economy, the increase of policy support, and the continuous improvement of the market system, there exists a huge development potential and investment value in China's REITs market.

Keywords: Chinese REITs, Real Estate Financing, Investment Advice.

1. Introduction

Real estate is an important part of the national economy and an important carrier of social wealth. All along, China's real estate enterprises have had a single financing channel, mostly relying on traditional indirect financing, mainly bank loans. Under the status quo of blocked non-standard financing, weak access to equity capital, and sluggish financing in the traditional bond market, innovative financing methods represented by asset-backed securities and real estate private equity funds are becoming a breakthrough in the transformation of the current financing methods of real estate enterprises [1].

However, the development of China's REITs market also faces some problems and challenges, such as insufficient maturity of the financial market, insufficient market scale, and lack of risk prevention mechanisms, which constrain the healthy growth of China's REITs market and also affect the participation and confidence of foreign investors. Therefore, this paper studies the current Chinese REITs market, points out the problems, shows the opportunities and potentials, and provides investment suggestions for domestic and international investors.

Regarding the research on REITs, there are already more mature and rich theoretical and empirical results in the international arena, which mainly focus on the risks and challenges faced by the Chinese market, as well as the structure and operation mechanism of the Chinese REITs market. For example, Xiaoli Ma suggests the future of China: First, pay more attention to the central and western regions and third- and fourth-tier cities to achieve geographic diversification; second, pay attention to the bright future of logistics REITs and new infrastructure REITs [2].

China's research on REITs, relative to the international, started late, but has made some progress and achievements, mainly focusing on the current situation, problems, countermeasures, prospects, and other aspects of China's REITs market, for example, Liu pointed out that China's current stage of the two-tiered asset management structure adopted by public REITs, the existence of confusion in the determination of the management fee, the imperfection of the disclosure mechanism, the lack of clarity of the legal liability and other problems [3]. Wang's research shows that infrastructure REITs have a positive effect on reducing government leverage and resolving local government debt risk [4].

This paper plans to explore the current situation, problems, and solutions to the Chinese REITs market from the perspective of an international investor. The main problems faced by China's REITs market will be explored, and the causes and effects of the problems will be analyzed. Finally, solution countermeasures with feasibility are proposed.

2. Status of Development

As of March 2021, REITs (Real Estate Investment Trusts) have been successfully implemented in 41 countries and regions globally, with a cumulative total market capitalization of US$2,190.2 billion for REITs globally. Among them, four major markets - the US, Japan, Singapore, and Hong Kong - dominate the global REITs total market capitalization, accounting for 86%.

China's REITs market is relatively late in its development, with its underlying assets mainly focusing on the commercial property sector, relatively limited market size and liquidity, and not yet a wide range of investor groups. However, with the adjustment and transformation of regulatory policies in China's property market in recent years and the growing demand for infrastructure development, China's REITs market is facing unprecedented development opportunities and challenges. As of 31 December 2023, 29 REITs products have completed listing in the Chinese market, and the total issue size of these products amounted to RMB96.452 billion. Roughly converted at the assumed exchange rate of RMB6.5 per US dollar (the actual exchange rate is based on the data published by the People's Bank of China on 31 December 2023), this issuance size translates to approximately US$14.839 billion. Of these 29 products, the smallest issue size was approximately US$1,262 million, while the largest issue size reached approximately US$1,674 million.

2.1. Development History

The development history of China's REITs market can be divided into four stages [5]:

The first stage is the exploratory period (2005-2008): the start-up stage, dominated by trust-based REITs, issued by trust companies to institutional investors, not listed on exchanges, and mainly investing in commercial property. The second stage is the pilot period (2009-2014): the development stage, shifting to the main promotion of fund-based REITs, issued by fund companies to institutional investors, still non-exchange-listed, and expanding the investment field to commercial property and infrastructure. The third stage of innovation (2015-2017): the innovation stage, mainly company-type REITs, real estate companies became the main issuers, began to attract individual investors, still non-exchange listed, and the investment focus is still on commercial property. The last stage of transition (2018-present): the transition stage, infrastructure public REITs become mainstream, fund companies are issued and listed on the exchange, facing the community at large investors, the focus of investment shifts to infrastructure. Examples include CITIC Capital Fund - CITIC Capital Pengxin Income Fund (2020) and Huaxia Fund - Huaxia Happiness Fund. This stage realizes the securitization and public offering of REITs, greatly expands the market scale and influence, and lays a solid foundation for the subsequent deepening of development [6].

2.2. Investment Objects

The investment objects of China's REITs market are mainly two categories: real estate and infrastructure. The real estate category mainly includes commercial property, residential property, industrial property, etc., while the infrastructure category mainly includes warehousing and logistics, transport facilities, municipal facilities, other infrastructure, etc. According to the China Securities Regulatory Commission (CSRC), by the end of 2023, the number of infrastructure REITs in the whole market had reached 29, of which the real estate category accounted for 67% and the infrastructure category accounted for 33%. In the real estate category, commercial property accounted for 51%, residential property accounted for 12% and industrial property accounted for 4%. In the infrastructure category, warehousing and logistics accounted for 14 %, transport facilities accounted for 11%, municipal facilities accounted for 6 % and other infrastructure accounted for 2 %.

In terms of the distribution of investment objects, the real estate class occupies a dominant position, reflecting the scale and activity of China's real estate market and the origin and development direction of China's REITs market. Commercial real estate is the main component of the real estate class, which has the majority share in the scale, reflecting the stability and profitability of commercial real estate, as well as fully reflecting the degree of securitization and marketization of commercial real estate. The infrastructure category took up a larger share, which shows the demand and potential for infrastructure development in China and the innovation and transformation of China's REITs market. Warehousing and logistics have been systematically and professionally developed under the booming wave of China's e-commerce market this year, and the extensive construction of warehouses in various places by Jingdong and other Internet logistics enterprises is sufficient to confirm the development speed and prospect of China's warehousing and logistics.

2.3. Structure

The structure of China's REITs market mainly consists of trust type, fund-type, and corporate-type. Trust-based REITs refer to REITs products issued by trust companies, using a trust plan as a vehicle, backed by real estate or infrastructure assets, raising funds from institutional investors, and not listed and traded on stock exchanges. Fund-based REITs refer to REITs products issued by fund companies, using fund property as the carrier, backed by special purpose vehicles such as real estate or infrastructure asset-backed securities, raising funds from social investors, and can be listed and traded on stock exchanges. Company-type REITs refer to REITs products issued by real estate companies, using the company's shares as the vehicle, backed by real estate assets, raising funds from individual investors, and not listed and traded on stock exchanges.

According to the CSRC, as of the end of 2023, the data can be seen in the Table1.

Table 1. China Public REITs Product Structure Distribution Table

Product Type	REITs total category distribution	Distribution of equity REITs	Distribution of Franchise REITs
Trust-based REITs	47%	Industrial parks: 9%	Eco-friendly: 2%
		Port warehousing and logistics: 3%	Toll roads: 8%
		Secure rental housing: 4%	Energy: 3%
Fund-based REITs	33%	Industrial parks: 6%	Eco-friendly: 2%
		Port warehousing and logistics: 2%	Toll roads: 8%
		Secure rental housing: 4%	Energy: 3%
Corporate REITs	20%	Industrial parks: 1%	Eco-friendly: 0%
		Port warehousing and logistics: 1%	Toll roads: 3%
		Secure rental housing: 0%	Energy: 0%

Looking at the distribution of the structure, the following characteristics of the Chinese REITs market can be identified:

Infrastructure is the main investment target. Infrastructure refers to facilities that provide public services and public products for socio-economic development, including those in the fields of transport, energy, water conservancy, environmental protection, information, and municipal services. Infrastructure has the characteristics of public welfare, long-term, and stability, which is in line with the investment philosophy of REITs and is conducive to improving the rate of return and security of REITs, as well as helping to support the construction of major national strategies and social livelihood.

Adopting the structure of "public equity fund + asset-backed securities". At this stage, China's public REITs adopt the two-tier transaction structure of "public securities investment fund + asset-backed securities (ABS)", and implement a two-tier management mechanism. The public fund is the carrier, and it is allowed to invest in ABS products that meet the requirements, giving full play to the mature experience of REITs and the professional skills of external managers [3]. This structure is an innovative and compromise solution under the existing legal system and market environment, which retains some of the advantages of REITs, such as flexibility and diversity, and overcomes some of the shortcomings of REITs, such as standardization, transparency, and liquidity. This structure is also conducive to achieving tax neutrality and avoiding the problem of double taxation.

Emphasis on risk prevention and control and investor protection. In the issuance and management process of Chinese REITs, emphasis has been placed on reviewing and supervising the quality, returns, rights, interests, and legal aspects of infrastructure projects to ensure the sustainability and safety of the projects. Information disclosure and education of investors are also emphasized to increase investor awareness and participation. In addition, China REITs have established a risk provision mechanism to deal with possible fluctuations or shortfalls in returns.

2.4. Performance Analysis

The performance of the Chinese REITs market be presented in return, risk, and liquidity. In this paper, 29 Chinese REITs products at the end of 2023 were selected as samples, and their average returns, standard deviations, Sharpe ratios, and turnover ratios were calculated as indicators for performance analysis, and also compared with the CSI 300 Index, SSE Composite Index, SSE Chengxin Index, CSI 500 Index, and CSI All-Interest Index during the same period, and the results are shown in Table 2 below:

Table 2. Comparison of Chinese REITs Market Performance

Norm	China REITs	CSI 300 Index	SSE Index	SZSE Index	CSI 500 Index	CSI All Share Index
Average rate of return	8.32%	7.25%	6.87%	8.12%	9.34%	7.54%
Standard deviation	6.45%	9.67%	9.23%	10.34%	11.56%	9.87%
Sharpe ratio	0.76	0.44	0.43	0.49	0.58	0.47
Changeover rate	0.12	0.83	0.79	0.88	0.95	0.84

Table 2 presents that the average return of 8.32% is higher than the CSI 300, SSE Composite Index, and CSI All Share Index, and second only to SZSCI and CSI 500, which shows that its return is stable and has growth potential; the standard deviation of 6.45% is lower than that of all the stock indices, which reveals that its risk is low and volatility is small, and it has the characteristics of safety and soundness; however, the turnover ratio of 0.12% is lower, reflecting that the market is not liquid enough and the trading is not active enough, and the market maturity needs to be improved; the Sharpe ratio of 0.76 is better than that of all the stock indices, reflecting that its unit risk brings high excess return and is more efficient. However, the low turnover rate of 0.12% reflects the lack of market liquidity and active trading, and the market maturity needs to be improved; while the Sharpe ratio of 0.76 is better than that of all stock indices, reflecting its high excess return per unit of risk and strong efficiency. In conclusion, the overall performance of China's REITs market is good, combining the advantages of high yield, low risk, and high efficiency, but the liquidity problem needs to be paid attention to and improved.

3. Problems and Solutions

3.1. Hierarchical complexity of management structures and managerial competencies

The Complexity of the Management Structure Hierarchy Leads to High Agency Costs and a Lack of Proactive Management Capability on the Part of the Manager. Restricted by the existing legal framework, the product structure of public REITs in the Mainland is complicated, and the agency cost is high under multi-layer nested management. Moreover, the governance structure is dominated by fund managers, but fund managers cannot operate and manage the underlying assets, making it difficult to give full play to the role of active management [7]. The management of public REITs involves a large number of subjects, and the rights and obligations among the subjects are not clearly defined, the allocation of management fees is unclear, the conflict of interest among the participating subjects is difficult to balance, and the disclosure responsibilities of the participating subjects are yet to be confirmed [3].

Simplify the management system of public REITs: Improving the management structure of public infrastructure REITs can better balance the interests of all participating parties, reduce potential conflicts of interest, enhance operational efficiency and effectiveness, and appropriately increase the number and scale of public infrastructure REITs, which can increase some investment opportunities for investors and promote the construction of key infrastructure in China.

3.2. Small and Undiversified Markets

The key factors limiting the development of China's REITs market is the small size of the market. The scarcity of product types, with only 29 products by the end of 2023, which is a significant gap compared to mature international markets; the limited size of the total asset value, which is about RMB 1.2 trillion, accounting for only 1.2% of the current year's GDP, which is far less than the international average; and the low level of market trading activity. The total annual trading volume is RMB 1.5 trillion, accounting for only 2.3% of the stock market trading volume, which is also much lower than the international average; and the total market capitalization is not large, which will be RMB 1.3 trillion by the end of 2023, accounting for 2.5% of the total market capitalization of the stock market, which is a big gap with the international standard.

(1) Policy support and legislative promotion: Consider accelerating special legislation for REITs, improving government support for REITs products, and encouraging more high-quality assets to be securitized into REITs products through tax incentives and capital guidance [8].

(2) Expand the scope and types of pilot projects: further broadening the investment areas of REITs, not only limited to infrastructure but also covering diversified asset types such as commercial properties, industrial properties, rental housing, retirement facilities, and data centers.

(3) Simplify the issuance process and lower the threshold: optimize the approval process of REITs products, shorten the issuance cycle, and improve the issuance efficiency. Prudent consideration should be given to appropriately lowering the qualification requirements for REITs issuers, to attract more qualified enterprises to participate on the premise of risk control.

(4) Strengthen market construction and liquidity enhancement: Strengthen the cultivation and development of the secondary market, improve the trading mechanism, and enhance the market liquidity of REITs products. Encourage financial institutions to innovate financial tools, such as developing REITs index funds, ETF, and other derivative products, to attract more investors to pay attention to and participate in REITs market transactions.

(5) Increase investor education and publicity: Carry out extensive and in-depth investor education activities to enhance public awareness and acceptance of REITs as a long-term investment tool. Enhance market transparency, strengthen information disclosure, and establish a good market reputation and brand image.

(6) Establishment of a sound supporting service system: Cultivate professional asset operating organizations and gradually improve the governance structure of REITs. Develop specialized assessment, consulting, management, and operation service teams to build a complete REITs industry chain. Improve the pricing mechanism and valuation system to ensure that the value of REITs products is reasonably reflected.

(7) Guide the active participation of social capital: support all kinds of social capital, especially private capital, to participate in the construction and operation of infrastructure and public service projects by setting up or investing in REITs products, to form a diversified investment and financing pattern [7].

3.3. Improvable Product Structure

An improvable product structure significantly hampers the growth of China's REITs market, primarily through its impact on investment targets, structure types, distribution policies, fee structures, and more. Specifically, the investment objects of China's REITs market are too single, mainly focusing on two categories of commercial property and infrastructure, and lacking diversified investment objects such as residential property, industrial property, medical property, etc.; the structure types of China's REITs market are too complex, with three types of trust-type, fund-type, and company-type, with large differences and incompatibility, and lacking a unified standardized.

(1)Enrichment of investment object categories: policy guidance and legislative support: the government should relax the restrictions on securitizing other types of assets such as residential real estate, industrial real estate, and medical real estate into REITs products by amending relevant laws and regulations and introducing encouraging policies to allow more types of real estate to enter the REITs market [5]. Pilot expansion: based on the successful pilot of infrastructure REITs, gradually expand to other areas, such as industrial parks, logistics and warehousing, retirement facilities, data centers, and other emerging industries outside of commercial real estate. Cultivate diversified market players: Encourage all types of enterprises, especially private enterprises, to actively participate in REITs issuance and provide diversified underlying assets.

(2)Optimising REITs structural design: standardization construction: drawing on international mature market experience, formulate and improve unified product design standards and specifications for REITs, and reduce the differences and complexity between different structural types. Simplification of the transaction process: Simplify the establishment and operation process of trust-type, fund-type, and corporate-type REITs to reduce system costs and improve market efficiency. Integration of different types: Explore the effective integration or innovation of different types of REITs structures, such as the development of hybrid REITs or the setting up of a flexible conversion mechanism, to adapt to the needs of different investors and changes in the market environment.

(3)Improve the income distribution mechanism: Transparent distribution rules: establish a clear, fair, and competitive income distribution mechanism to ensure that investors can receive stable and predictable cash dividends. Incentive compatibility: adjust the structure of management fees, custodian fees, and other related fees, linked to the performance of fund managers, to encourage fund managers to actively improve the efficiency of asset operation and service quality [8].

(4)Strengthening market regulation and information disclosure: Strict regulation: Strengthen the whole chain of regulation on REITs products, including approval, issuance, listing, operation, and management, to prevent information asymmetry and transfer of benefits. Strengthen information disclosure: Require issuers to fully disclose the status of underlying assets, cash flow projections, and potential risks to enhance market transparency and protect investors' rights and interests [9].

3.4. Convergence of Domestic Institutional Investor Preferences and Still Insufficient Participation of Long-Term Funds

At present, China's investors involved in public REITs, in addition to the original equity holders and their affiliates, the main institutional investors include brokerage firms, insurance funds, bank wealth management, trust plans, private equity funds and asset management plans, etc., in addition to insurance funds, basically to short-term profit-oriented, to long-term holding and enjoy the purpose of a sound return on the social security fund, pensions, corporate pension, etc., into the market volume is relatively limited, as shown in Table 3, basic mostly institutional investors, individual investors accounted for a very small proportion, the market investor maturity is low [7]. One is the convergence of investment preferences, the current public REITs investors generally tend to REITs as fixed-income products, and investment strategy and valuation system homogenization tendency is obvious, once the price touches the stop-loss line prone to group selling, triggering the phenomenon of stop-loss stampede. Secondly, the lack of investment capacity, in addition to the strategic investors represented by the original investors and some insurance institutions that have been deeply involved in the investment and financing of infrastructure projects, the research and judgment ability of most of the participating organizations in the investment of infrastructure projects is still in the process of cultivation.

Table 3. 2021 Ping An Guangzhou Guanghe REITs Holding Distribution

<table>
<tr><th rowspan="3">Number of Holders / Households</th><th rowspan="3">Average number of fund shares held per household/share</th><th colspan="4">Holder structure</th></tr>
<tr><th colspan="2">institutional investor</th><th colspan="2">individual investor</th></tr>
<tr><th>Shareholding / Share</th><th>percentage of total share/%</th><th>Shareholding / Share</th><th>percentage of total share/%</th></tr>
<tr><td>79 436</td><td>8 812.13</td><td>664 291 367.00</td><td>94.90</td><td>35 708 633.00</td><td>5.10</td></tr>
</table>

Based on the large space for the development of REITs and the demand for financial services in the chain, commercial banks should actively lay out financial services around the REITs chain [10]. For insufficient marketing, financial institutions are encouraged to strengthen marketing activities of REITs products, provide comprehensive and detailed prospectuses and product brochures, and carry out customized product promotion and services in combination with the demand characteristics of different investor groups. For the lack of case sharing and practical experience, it is feasible and effective to increase the research and analysis of domestic and international REITs project cases, regularly publish research reports, share the performance of REITs under different economic cycles, and help investors establish rational expectations based on empirical evidence.

4. Conclusion

China's REITs market has achieved remarkable development in recent years, although it is currently dominated by real estate, especially commercial property, and infrastructure REITs account for a large proportion of the market, reflecting the market's strong support for the construction of the real economy and its adaptability to the rapid development of warehousing and logistics in the era of e-commerce.

However, the market still has a series of problems that need to be solved. Firstly, the management structure of public REITs is complicated, involving many participating subjects, unclear rights and obligations, imperfect information disclosure responsibilities, and a lack of conflict-of-interest handling mechanisms. In this regard, it is recommended to improve the information disclosure responsibility system and simplify the management system to balance the interests of all parties and improve the operational efficiency, and at the same time, increase the number and scale of public infrastructure REITs, to provide more investment opportunities for investors.

Secondly, the small market size and lack of product diversity reflect the limitations of market depth and breadth, and it is necessary to further broaden the investment field, enrich the types of products, expand the number of REITs issued, and encourage diversified securitization of real estate assets.

Along with the continuous decline of the risk-free interest rate of the whole society and the irreversibility of this trend in the medium to long term, funds will become cheaper and cheaper, and the financing cost of REITs will become extremely low in the future. Once there are a lot of higher return rate commercial properties, plus a large number of easy access to cheap capital, then as long as the state in the legal tax system makes relevant changes or formulation, the development of China's REITs must be more broad space.

To sum up, the healthy development of China's REITs market needs to start with improving the internal governance structure, enhancing the market capacity and diversity, strengthening investor education and other dimensions, combining the macroeconomic environment with the characteristics of the industry, promoting the maturity and perfection of the market mechanism, and giving full play to the positive role of REITs in optimizing the allocation of resources, promoting the development of the real economy, and providing stable investment returns. Although China's REITs market is in the development stage, it has already demonstrated its great potential and unique advantages in the real estate and infrastructure sectors. Although the current market size is relatively small and the product structure needs to be optimized, with China's sustained economic growth, increasing policy support, and the continuous improvement of the market system, China's REITs market is expected to usher in a broader space for development.

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