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LongTerm Impactof Real Estate Investment Trust (REIT) On Private Hospital: A Case Studyin Malaysia

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Abstract:*Hospital A went for REIT exercise in October 2009. By doing this exercise, REIT took over the building and the land with the payment of RM 48 million which was divided into RM 23 million cash and RM 25 million in term of shares so that the hospital would enjoy yearly dividend. With this exercise, Hospital A was able to settle loans given by the Parent company and bank and also outstanding payment to suppliers. However the hospital had to pay monthly rental of RM 320,640 in year 2009, RM 325,233 in year 2010, RM 329,825 in year 2011 and RM 334,418 in 2012. If Hospital A remained as NON- REIT, it will have to take into account the depreciation of the building , to pay for the interest charged by the Parent company , interest charged by suppliers and bank . For 2009, the cost for NON- REIT was higher by 87.62% compared to REIT. However, from 2010 onwards, the cost for REIT was higher by 6.43% in 2010, 9.75% in 2011 and 11.67% in 2012 compared to NON- REIT. By going into REITexercise ,Hospital A had to pay additional cost of RM 124,971 in year 2010, RM 189,568 in year 2011 and RM 226,826 in year 2012.In total, Hospital A had to pay RM 6,431,764 compared to RM 6,316,111 if remained as NON- REIT for the whole period of October 2009 until December 2012.With the additional cost, the Profit Before Tax was reduced by that numbers. Therefore, in the long run, REIT did not benefit Hospital A due to the increase rental cost of the property. The same principle will apply to any private hospital in Malaysia.*

I. Introduction

Real Estate Investment Trust (REIT) is a company that owns or finances income-producing real estate. REIT which was modelled after mutual fund, provides all types of regular income streams, diversification and long-term capital appreciation to investors as dividends to shareholders. In turn, shareholders pay the income taxes on those dividends. Anyone is allowed to invest in portfolios of large-scale properties the same way they invest in other industries through the purchase of stock and in the same way shareholders benefit by owning stocks in other corporations . The stockholders of a REIT earn a share of the income produced through real estate investment without actually having to go out and buy or finance property. Equity REITs and Mortgage REITs are the two main types of REITs. Equity REITs generate income through the collection of rent and from sales of the properties they own for the long-term. Mortgage REITs invest in mortgages or mortgage securities tied to commercial and/or residential properties. However today, REITs are tied to almost all aspects of the economy including apartments, hospitals, hotels, industrial facilities, infrastructure, nursing homes, offices, shopping malls, storage centres, student housing, and timberlands (REIT.com).

For many years there had been a large gap between REIT industry research and academic research. On the industry side, major research efforts had been devoted to analyse various REIT risk measures such as debt levels, EBITDA, the volatility of the prices and the variability of FFO in business cycles. On the academic side, due to the lack of quality data most studies have analysed REIT returns using only NAREIT and other REIT index (Acton, M. 1997)

A study was conducted to assess the risk and return in real estate. Basic information is provided on the returns and risks from 1978 through 1985 for unleveraged equity real estate compared with stocks and bonds. Data resources include the Russell-NCREIF index, Evaluation Associates index and the Goldman Sachs equity real estate investment trust index. Based on the finding it was found that aggregate return for the publicly traded equity real estate investment trust index was nearly twice that of the other real estate series and more than twice that of Standard & Poor index. The equity real estate investment trust is far more volatile than the other two real estate series. Neither the Goldman Sachs nor the other two indexes exactly measure the returns or risks on equity real estate. The volatility of the equity real estate investment trust leads it to overstate the risk of this investment category, while the other two indexes are not return indexes. This study indicates that real estate risks lies plausibly midway between that of stocks and bonds in a range of 9 percent to 13 percent (Ross,S.A. 1991).

Another study was conducted to find out the corporations' choices between REITs and other methods of financing. This study examines the financing methods used by corporations to acquire real estate for their operations and it also examines the opinion of managers about the factors that they consider in choosing financing methods. The data were provided by a survey questionnaire that was sent to members of the

International association of Corporate Real Estate Executives and it was found that companies rely on internal financing and external financing such as long term leasing, joint ventures, property mortgages and sale/leaseback arrangements. The top ranking methods of finance include operating cash flows, property mortgages, leasing and sales/leasebacks. Use of real estate investment trusts, collateralised mortgage obligations and mortgage-back securities were the lowest-ranked forms of financing (Redman,A.L. 2002)

Real estate investment trusts that own health care properties are called Health Care REITs. Health Care REITs are required to pay out 90% of their taxable income in dividends and with this payment it will increases shareholder return. However with this payment most Health Care REITs are unable to finance expansion from operating income, instead issuing equity and debt. Due to reliance on debt, it had causes Health Care REITs to be particularly sensitive to changes in interest rates and with fluctuating of interest rates it can impact debt service payments on variable rate debt, decrease a REITs' stock price as bonds provide greater returns, or increase the cost of issuing new debt, slowing expansion (wikinvest.com).

Deals between real estate investment trusts (REITs) and hospital operating companies are expected to multiply as more providers realize it's time to cash in on their bloated real estate portfolios. Acute-care hospitals which are cost intensive are just one element of the entire continuum of care that health systems need to control and providers are determining which part of the system they need to own outright and where they could monetize their real estate. As more people gain insurance and the population ages, REITs are also banking on a continuing strong demand for healthcare services. Due to demand, there's been an increasing amount of competition to own hospital facilities. As an example,Capella Healthcare, a privately-held, Franklin, Tenn.-based hospital operating chain, was sold to REIT in $900 million deal. Medical Properties Trust, which focuses exclusively on acute-care facilities, will own Capella's real estate, while operations of its 11 hospitals will be jointly owned and managed by the REIT and the chain's senior management (Kuthcher, B. 2015).

In Malaysia, REITs are not new and previously they were known as property trusts. In January 2005, guidelines on REIT were introduced and this guidelines revamp the old property trust guidelines. In the same year the Shariah Advisory Council of the Security Commission of Malaysia had released the guidelines for Islamic REIT. An Islamic REIT invests primarily in income producing Shariah compliance real estate and or real estate related assets. Similar to conventional REIT, Islamic REITs are managed by professional managers who have specialised knowledge of real estate and real estate related assets. Those assets are liquid assets, which can be listed and traded on Bursa securities and making it attractive to investors who are able to invest and diversify their real estate investments without large capital . Under the new Guidelines for Islamic REITs, Al Aqar KPJ REIT was listed on the Main Board of Bursa Securities. This REIT was the world first listed Islamic REIT, Asia first healthcare REIT and the first listed Islamic REIT under the new SC guidelines for Islamic REIT. The sponsor of Al Aqar KPJ REIT is KPJ Healthcare, the healthcare arm of Johor Corporation which is the first home-grown healthcare group in Malaysia with more than 25 years of experience in healthcare industry. For the listing, KPJ initially injected six hospital buildings owned by the group in prime locations nationwide into the REIT. Al Aqar REIT is expected to yield a competitive market rate of more than 7% for the financial years ending on the 31st December 2007 until 31st December 2009 (islamicfinancenews.com)

II. Objectives

1. To compare the impact on costs for Hospital A if remain as NON-REIT and after going for REIT exercise
2. To analyse the future problem of REIT

III. Methodology

Case study method was chosen to conduct the study. In this study,Hospital A which is a new private hospital in Malaysia was chosen as sample. Various data were collected related to the depreciation of the building, interest charged per year by the parent company, suppliers and bank. Data were also collected regarding the comparison of cost between REIT and NON- REIT on Hospital Afrom year 2009 to year 2012 and all data were collected from the Finance Manager of Hospital A through the following process:

1. Initial contact with the organization through phone calls and conduct interview via telephone
2. Draft and submit the official letter using email
3. Received the required data from the hospital

After all data were collected , they were sorted out in each category. Data were tabulated according to the depreciation ofbuilding, interest charged per year by the parent company, suppliers and bank and cost comparison between REIT and NON-REIT.

IV. Results

If Hospital A remain as NON-REIT, the hospital has to take into account the depreciation of the building as shown in table 1, pay the interest of loans from the Parent company as shown in table 2, interest charged by suppliers as shown in table 3 and interest charged by bank as shown in table 4.

Table 1: Depreciation of Building (2%) Per Year

Year 2009 (Oct-Dec 2009)	RM 189,999
Year 2010	RM 760,000
Year 2011	RM 760,000
Year 2012	RM 760,000

Source: Report from Financial services of Hospital A

Interest of Loan

a. Parent company (1.50% interest) with the total loan of RM 6,563,057

Table 2: Interest charged from year 2009 to year 2012

Interest(Oct –Dec 2009)	RM 24,611
Interest year 2010	RM 98,446
Interest year 2011	RM 98,446
Interest year 2012	RM 98,446

Source: Report from Financial Services of Hospital A

b. Supplier (1% interest)   with total loan of RM 881,028

Table 3: Interest charged from year 2009 to year 2012

Interest(Oct –Dec 2009)	RM 2,203
Interest year 2010	RM 8,810
Interest year 2011	RM 8,810
Interest year 2012	RM 8,810

Source: Report from Financial Services of Hospital A

c. Bank (7.80% interest) with the total loan of RM 13,796,958

Table 4 :Bank interest from year 2009 to year 2012

Interest(Oct –Dec 2009)	RM 269,041
Interest year 2010	RM 1,076,163
Interest year 2011	RM 1,076,163
Interest year 2012	RM 1,076,163

Source: Report from Financial Services of Hospital A

Comparison of Cost Between NON-REIT and REIT

Table 5: Cost comparison from year 2009 to year 2012

YEAR	NON- REIT (depreciation +interest on loan)	REIT (rental –dividend)	Variance
Oct-Dec 2009	RM 485,854	RM 60,142	(87.62%)
2010	RM 1,943,419	RM 2,068,390	6.43%
2011	RM 1,943,419	RM 2,132,987	9.75%
2012	RM 1,943,419	RM 2,170,245	11.67%

Source: Report from Financial Services of Hospital A

Cost different between NON-REIT and REIT

Table 6 :Cost different between REIT and NON- REIT from year 2009 to year 2012

Year	Different
Oct-Dec 2009	RM 425,712
2010	RM(124,971)
2011	RM (189,568)
2012	RM (226,826)

Source: Report from Financial Services of Hospital A

V. Discussion

REIT is good to unlock assets, to get liquidity and dividend**.** However, in the long run, the rental imposed by REIT will burden the hospital because the amount of dividend enjoyed by the hospital is less compared to the rental charges which will continue to increase by 2% every two years. Hospital A went for REIT exercise in October 2009. By doing this exercise, REIT took over the building and the land with the payment of RM 48 million which was divided into RM 23 million cash and RM 25 million in term of shares so that the hospital would enjoy yearly dividend. With this exercise, Hospital A had to pay monthly rental of RM 320,640 in year 2009, RM 325,233 in year 2010, RM 329,825 in year 2011 and RM 334,418 in 2012.

If Hospital A remained as NON REIT, it will have to take into account the depreciation of the building as shown in table 1, to pay for the interest charged by the Parent company as shown in table 2, interest charged by suppliers as shown in table 3 and bank interest as shown in table 4. Total depreciation cost for the building from year 2009 to year 2012 as shown in table 1 was RM 2,469,999.

Table 2 shows the interest charged by the parent company from year 2009 to 2012. For 2009, interest charged was only RM 24,611 for a period of three months. For 2010 onwards, interest charged was RM 98,446 each year. In total, interest charged by the parent company from 2009 to 2012 was RM 319,949.

In year 2009 the interest charged by suppliers was only RM 2,203 which can be seen in table 3. However, interest charged for 2010 onwards was RM 8,810 per year. In total, the interest charged was RM 28,633. In term of bank interest RM 269,041 was charged in 2009.However, for 2010 onwards the interest was RM 1,076,163 per year and this can be seen in table 4. In total RM 3,497,530 was charged from year 2009 to year 2012.

Table 5 shows that for 2009, the cost for NON- REIT was higher by 87.62% compared to REIT. However, from 2010 onwards, the cost for REIT was higher by 6.43% in 2010, 9.75% in 2011 and 11.67% in 2012 compared to NON- REIT. In conclusion, the cost for REIT continued to increase every year. By going into REIT,Hospital A had to pay additional cost of RM 124,971 in year 2010, RM 189,568 in year 2011 and RM 226,826 in year 2012 which can be seen in table 6. With the additional cost, the Profit Before Tax was reduced by that numbers. Therefore, in the long run, REIT did not benefit Hospital A due to the increase rental cost ofthe property. The same principle will apply to any private hospital in Malaysia.

VI. Conclusion

The building and land of Hospital A was sold to real estate investment trust in October 2009. However other assets still belong to the hospital. By entering into REIT, Hospital A managed to generate RM 48 million which was divided into RM 23 million cash and RM 25 million in term of shares. With the availability of cash, Hospital A managed to settle the outstanding loan from the Parent company, Bank and settle all the outstanding payment to suppliers. Hospital A also enjoyed the yearly dividend paid by REIT. For the first year from October to December 2009, Hospital A enjoyed the benefit of going into REIT exercise where this hospital only paid total expenses of RM 60,142 compared to RM 485,854 if this hospital remainedas NON- REIT. However for year 2010, Hospital A had to pay RM 2,068,390 compared to RM 1,943,419 if remained as NON- REIT, RM 2,132,987 compared to RM 1,943,419 for NON- REIT in 2011 and RM 2,170,245 compared to RM 1,943,419 for NON- REIT in 2012 . In total , Hospital A had to pay RM 6,431,764 compared to RM 6,316,111 if remained as NON-REIT for the whole period of October 2009 until December 2012. Therefore going for REIT is not benefiting Hospital A in the long run due to the increase of rental cost.

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