From Vision to Value: Unlocking Egypt's Real Estate Potential through Real Estate Investment Trusts

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Abstract

As per Egypt's Vision 2030, Financial Regulatory Authority ("**FRA**") emphasizes its responsibility for economic and social growth. Drawing attention to the capital market, with its advanced technology and well-established regulations, has managed to create an attractive environment for investments.[i] Real Estate Investment Trusts ("**REITs**") are classified as securities under Capital Market Law No. 95 of 1992, which is one of the capital market's major instruments.

Furthermore, international real estate investments revolve around three main sectors:

Firstly: Direct investments involve Real Estate Investment Funds ("**REIFs**").

Secondly: Indirect investments involve two sub-sectors: Real Estate Investment Trusts ("**REITs**") which are the main discussion of this article, divided into I) Equity REITs ("**E-REITs**"); II) Mortgage REITs ("**M-REITs**"); III) Hybrid REITs ("**H-REITs**"). And Real Estate Investment Trust Exchange-Traded Funds ("**REIT ETFs**").[ii]

Thirdly: Development Projects ("**DP**").[iii]

In addition, the Egyptian Capital Market ("**ECM**"), involved REIFs, E-REITs, and DP. There is a relationship between real estate portfolio management and fluctuations and REITs' risks; to attain growth in REITs, Egypt has to seek equilibrium in the equation that ties them together.

Finally, this article presents an overview of the current REITs in Egypt and some worldwide comparisons and strategies for ECM's improvement.

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Historical Overview

Evolution and Global Adoption of REITs

The REITs were created first in the United States ("**US**") in 1960 under President Dwight D. Eisenhower as part of the Cigar Excise Tax Extension Act of 1960[iv] and National Association of Real Estate Investment Trusts ("**NAREIT**") handbooks between 1997 and 2006 years, stated that less than 10% of the REITs in the US E-REITs are diversified by property type in terms of either total market capitalization or number of REITs. The other 90% of E-REITs specialize in one property type or occasionally two closely related property types, seems that E-REITs gained popularity particularly during the late 1960s.[v]

In the global market, several states adopted REITs in their systems, such as Egypt in 1992 through Law No. 95 of 1992, the United Kingdom ("**UK**") in 2006 through the Finance Act 2006, and the United Arab Emirates ("**UAE**") in 2010 through UAE Financial Services Authority Law No. 2 of 2010.

REITs in Egypt

The REITs were recognized by Law No. 95 of 1992 "Capital Markets" as considered a legal foundation for REITs, although it did not provide a full comprehensive framework. In 2000, Egypt issued Law No. 93 of 2000 and its Executive Regulations on the Central Depository and Registration of Securities and Law No. 10 of 2009 on Regulating Supervision of Non-Banking Financial Markets and Instruments, signifying the beginning of the milestone.

In addition to the Presidential Decrees in 2009, Decree No. 191 of 2009 established the Provisions Regulating the Egyptian Stock Exchange and its Financial Affairs. Second Decree No. 192 of 2009 issued the Articles of Association of FRA. Furthermore, FRA issued several regulatory decisions, including Regulatory Decision No. 34 of 2014, which outlined the fundamental requirements for the establishment and operation of REITs in Egypt. This will be outlined deeply throughout one of the sections of this article.

REITs have the potential to revolutionize ECM, on the other hand, REITs are hindered by regulatory challenges and real estate portfolio management and fluctuations.

REIT Categories and Property Segmentation

REIT

Real Estate Investment Trust ("**REIT**") is a contemporary investment vehicle that enjoys tax exemption on the income distributed to its shareholders and shall be expected to invest a required percentage of its fund in Real Estate Assets to enjoy such tax exemption.[vi]

REIT is divided into two main sectors:

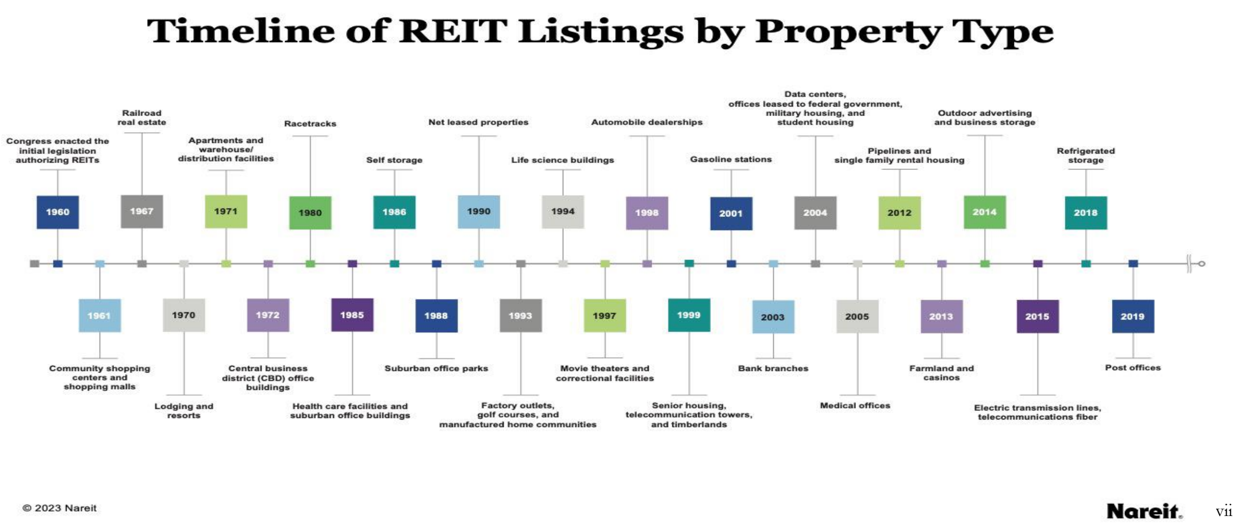
<u>Diversified REIT</u>

When REIT operates in a large range of sectors of real estate property types, REIT gains its portfolio across various types of real estate assets, although REIT reduces the risks associated with downturns in any particular real estate sector.

Specialized REIT

When REIT operates in focus on a single type of real estate property, REIT gains and concentrates its portfolio on a specific real estate asset, although REIT its performance is closely tied to the specific sector.

Property Segmentation



Essential Aspects of REITs

In global markets, investors invest in REITs, which can be categorized into three (3) sectors:

E-REITs:

REIT owns and manages properties, generating revenue primarily through leasing these properties to tenants. In addition, E-REITs' revenues are mainly generated from rental incomes from their real estate holdings and target high-yield dividend payouts. Furthermore, risk is related to property management, tenant turnover, and market fluctuations (supply and demand dynamics as well as interest rates, which shall be low as they have a direct proportional relation with inflation); therefore, risk management diversities across different property types and geographic locations as well as tenant turnover and property management.

Nonetheless, investors should invest in high-growth markets with increasing demand for rental properties in urban developments or sectors benefiting from demographic trends.

In the context of market cycles, E-REITs demonstrate distinct behaviors influenced by numerous economic factors. Predictably, during periods of economic enlargement, demand for rental properties increases, leading to higher occupancy rates and rental prices. This cycle often enhances the performance of E-REITs, as their revenue from rent outpaces costs.

M-REITs:

REIT provides financing to third parties through loans or mortgages secured by real estate and trades and invests in mortgage-backed securities in a mix of short-term and long-term financing options. In addition, M-REITs generate tiger revenues from the interest earned on their mortgage loans and look for high dividend yields, often higher than E-REITs. Furthermore, risk is exposed to interest rate risk and credit risk associated with the quality of mortgages; therefore, risk management employs interest rate hedging strategies and monitors the credit quality of mortgages.

Nonetheless, investors should monitor interest rate trends and macroeconomic factors and invest during periods of low interest rates.

In relation to market cycles, the performance of M-REITs is particularly sore due to interest rate fluctuations. When interest rates rise, the cost of borrowing increases, which can affect the profitability of these trusts. Contrarywise, declining interest rates may improve their operating margins, benefiting their performance within growing market cycles.

H-REITs:

REIT conducts both activities: owning properties and leasing them out, as well as providing financing to third parties through loans or mortgages. In addition, the revenue for H-REITs, a more balanced approach, comes from both rental income and interest in the financing provided.[viii] Furthermore, risk is subjected to a combination of risks from property and mortgage investment; therefore, risk management uses a balanced approach from both real estate and mortgage investments and adjusts focus based on market conditions.

Nonetheless, investors should adopt strategies based on prevailing market conditions, shifting focus between property investments and mortgage lending as needed.

In particular, H-REITs persist in a significant position in the discussion of REITs and market cycles, appealing to investors pursuing both steady income and development potential.[ix]

Finally, investors in REITs can gain profits through dividends received during the fiscal year and potential capital gains when they sell their shares.

REITs in Egypt

We should examine the aforementioned laws and decrees closely to clarify all the legal concepts and frameworks that characterize the growth of REITs, and the direction Egypt has chosen to emphasize within the REIT system in ECM, in alignment with Egypt's Vision 2030.

Laws

Capital Markets Law No. 95 of 1992

REITs shall be adopted by this law which is the primary legislation governing the establishment and regulation of REITs in Egypt.

Observed: its articles define investment funds to invest in securities and other assets, set the general rules for establishing, operating, and managing of investment funds and companies, and specify the requirements for issuing securities.

Income Tax Law No. 91 of 2005

This law governs the taxation of individuals and corporations which sets regulations on taxable income, tax rates, deductions, and exemptions, with distinct sections for individual and corporate income tax.

Accordingly, under Article 46 Bis 2/3, the investor shall tax dividend distributions at 5% for REITs as well as capital gains from the sale of those REITs or REIT shares are subject to tax, whether the gains are realized in Egypt or abroad. In line with Article 47, the REIT shall tax net profits annually.

Finally, there are related laws which govern REITs such as Law No. 93 of 2000 and its Executive Regulations on the Central Depository and Registration of Securities and Law No. 10 of 2009 on Regulating Supervision of Non-Banking Financial Markets and Instruments

Presidential Decrees

Presidential Decree No. 191 of 2009

This decree established the provisions regulating the Egyptian Exchange ("**EGX**") and its financial affairs, which outlines the operational framework, governance, and regulatory mechanisms for the stock exchange to ensure transparency, stability, and investor protection in the financial markets. In addition, this decree aims to enhance the overall effectiveness of capital market operations in Egypt.

Presidential Decree No. 192 of 2009

This decree is issued the articles of association of FRA, which outlines the governance structure, responsibilities, and operational framework of FRA, which regulates REITs.

Regulations

Executive Regulation of Capital Markets Law No. 95 of 1992 & its amendments[x]

The table below shows the relevant articles in this executive regulation related to REITs

Article No.	Subject	
140	Legal Form	To establish an investment fund, it shall take the form of a joint stock company
	Type of REITs	REITs established in Egypt take the form of E-REITs
	Type of Funds	REITs are characteristic of closed-end funds
	Assets	REITs invest in real estate assets, including land, built properties, and other assets that ensure a certain level of liquidity

142	Minimum Capital	The issued and paid-up capital of the REIT shall not be less than five million Egyptian pounds or its equivalent in foreign currencies
144	Required License	The REIT shall be obligated to obtain a license from FRA
147	Issuance	The fund issues nominal investment documents at a single value in exchange for the investors who subscribe to them paying the full amount in cash, provided that it shall not exceed fifty times the capital of the REIT
151	Disposal of Capital	The REIT shall not dispose of the minimum investment documents subscribed to throughout the duration of the fund unless obtaining the approval of FRA
183	This article stipulates the types of investments of the real estate fund and the necessary conditions to exist in the real estate assets.	
183 Bis 1	Insurance	The REIT shall ensure its assets
183 Bis 4	Management Services Company	The management services company shall be responsible for preserving all documents and records related to the fund's assets which shall be listed before FRA
183 Bis 15	Stock Exchange Listing	REITs shall be listed on a recognized stock exchange in Egypt, such as EGX[xi] (Market cap of listed REIT hits EGP 80.2 bn in 2019)[xii]

Regulatory Decision No. 34 of 2014 (Amended by Regulatory Decision No. 1 of 2016)[xiii]

This decision was issued by FRA providing the minimum REIT's assets shall be invested 70% of its assets in real estate assets which include real estate assets that are owned, constructed, completed, or developed, along with financial assets related to real estate activities. In addition, the percentage of real estate assets (including financial assets related to real estate activities) held by REIT shall not exceed 95% of the total assets of the fund.

Regulatory Decision No. 58 of 2018 (Last Amended by Regulatory Decision No. 229 of 2024)

This decision was issued by FRA regarding the rules, controls, and procedures for licensing banks and certain companies that conduct non-banking financial activities to engage in investment fund activities either independently or with others with obtaining a license from FRA upon fulfilling the seven conditions specified in this decision.[xiv]

Finally, many regulatory decisions have already been issued by the FRA[xv] and other authorities that have an indirect relation to the requirements and structures of REITs; nevertheless, the FRA has to issue more regulatory decisions, which the REIT system is currently evolving.

Comparative View

First and foremost, each state has its own exclusive market, financial crisis, and market requirements and constraints, as the state shall target its tenants and investors in order to attain its potential growth. Therefore, Egypt shall pick which factors correspond to ECM for improving its REITs ecosystem. There are enticing factors in each selected state, as follows:

US

As stated, the US is a Pioneer in REITs, which is one of the oldest, most developed, and overseen by Securities and Exchange Commission ("**SEC**") which was established in 1934. SEC provides the key regulations include:

i. REITs shall distribute at least 90% of their taxable income to shareholders;
ii. A minimum of 75% of total assets must be invested in real estate and generate at least 75% of its gross income from real estate-related sources; and
iii. REITs can be in the form of publicly traded REITs which are listed on stock exchanges and also non-traded REITs which are not listed but still registered with SEC.[xvi]

Furthermore, REITs enjoy exemption from federal corporate income tax as REITs meet the above-mentioned requirements, but the variations in state REIT tax laws impact the taxation of REITs at the state level for example not only; state corporate income tax, state dividend taxation, state real estate transfer taxes, state franchise or business tax, and state nexus and apportionment rules.[xvii]

Finally, SEC provided the three types of REITs: E-REITs, M-REITs, and H-REITs and NAREIT highlighted that most REITs are traded on major stock exchanges as well as E-RIETs and M-REITs are the two main types of REITs in US.[xviii]

UK

REITs were introduced in the Finance Act 2006 and came into force on 1 January 2007 which are regulated by the Financial Conduct Authority ("**FCA**"). FCA provides the key regulations include:[xix]

i. REITs shall distribute at least 90% of their taxable income to shareholders as dividends;
ii. REITs shall Invest at least 75% of their total assets in real estate property and derive 75% of their income from property rental activities; and
iii. REITs shall be listed on a recognized stock exchange in UK, such as London Stock Exchange.

Furthermore, REITs enjoy exemption from corporation tax on profits from their property rental business but enjoy taxes on profits from non-qualifying activities. On the other hand, shareholders face taxation on dividends received from REITs.[xx]

Finally, FCA provided only one type of REIT, which is E-REITs.

UAE

UAE created innovation and adaptation in a competitive market that attracts local and international investors to invest in its state. In 2014, REITs governed primarily by the Securities and Commodities Authority regulations. Key regulations include:

i. REITs shall be distributed at least 80% of their profits;
ii. A minimum of 75% of total assets must be invested in real estate; and
iii. REITs shall be listed on a recognized stock exchange in UAE, such as Dubai Financial Market and Abu Dhabi Securities Exchange.[xxi]

Furthermore, Dubai International Financial Centre has created strong support for the quick development of REITs in its state, focused on facilitating foreign investment, ensuring compliance, and promoting transparency[xxii] and indeed facilitates the establishment of three types of REITs in the UAE: E-REITs, M-REITs, and H-REITs.[xxiii]

In addition, REITs favor a favorable tax environment, as announced by the Ministry of Finance in Cabinet Decision No. 81 of 2023, which outlines additional conditions for investment funds qualifying under Federal Decree-Law No. 47 of 2022 regarding corporate taxation. This decision highlights certain conditions that REITs have to meet to qualify for tax exemption:

i. Real estate asset values (excluded land) above 100 million AED;
ii. At least 20% of capital is publicly traded or fully owned by two or more institutional investors; and
iii. Maintained an average of 70% in real estate assets annually.[xxiv]

Finally, according to the Federal Decree-Law No. 8 of 2017 on Value Added Tax ("**VAT**"), REITs may qualify for VAT exemptions as per Article 45, which stipulates that the leasing or sale of residential properties shall be exempt from VAT, on the other hand, commercial property transactions may incur VAT at the standard rate of 5% as per Article 3; REITs can recover input tax as per Article 55 for related expenses incurred in taxable activities, provided they maintain proper records as per Article 69.[xxv]

Area of Improvement

Egypt shall adopt multiple aspects of development from the systems of the aforementioned states. Below are the key insights derived from each system, presented for consideration:

i. FRA shall enhance its contributions by developing distinct types of REITs with well-established designated legal framework, specifically, by providing M-REITs and H-REITs as well as REIT ETFs; to fulfill varied investment demands and capitalize on the growth of REITs in ECM.
ii. Adopting robust investor protection mechanisms to be a more secure and attractive investment option, which obtains confidence to investors in the REIT's ability to provide returns.
iii. Creating a more flexible and investor-friendly environment by considering tax exemptions or reductions on REIT income and capital gains. Additionally, fostering foreign investment through incentives and simplified processes could attract international capital to Egypt's growing market.

Based on the aforementioned essential takeaways from each system, Egypt shall concentrate its efforts on multiple approaches to achieve the growth potential of REITs in Egypt, not only through implementing or adopting those takeaways but also by eliminating the state's challenges which are considered a high challenge faced by REITs as it is one of the types of robust investments tools, that will be discussed in the subsequent sector.

Challenges faced by REITs

Governmental Issues

Prior to looking ahead to our development potential of REITs in ECM, we shall consider these three major issues:

i. Issue One: How is continued volatility in Egypt impacting the recovery of the commercial real estate market as well as ECM?

As the Egyptian pound devalues against other currencies, international investors will see the value of their holdings in Egypt plunge. Volatility in the bond markets does not benefit the real estate business, and if Egypt fails to implement the necessary structural reforms, life in the bond market may become much more tougher. This will certainly have an impact on both properties and REITs.

Dubai's Real Estate and Economic Reform Model

Around the years 2008 and 2009, Dubai faced a real estate bubble that led to a significant downturn in property prices and construction activity, exacerbated by excessive leverage, speculative investments, and reliance on foreign capital.

Based on the outcomes of this case, Egypt shall avoid overreliance on foreign investment, implement stronger regulatory oversight, and develop sustainable growth strategies.

ii. Issue Two: What are the practical consequences for investors of the ongoing Egypt debt crisis?

There is concern over the impact of an Egyptian pound devaluation on commercial contracts and loan agreements. Investors should be advised to carefully analyze contracts and future proof where possible. All assets should be assessed in relation to redenomination risk.

iii. Issue Three: What are the implications of Egypt's crisis on investment diversification?

Egypt is likely to remain relevant to global investors despite continued economic malaise. New investors from energy-rich countries could become an important source of capital for the state. Counter-cyclical investment is not attractive at current values and given the high levels of debt. Investors should not expect the market to be stable in the long term.

Greece's Sovereign Debt Crisis

Greece's financial crisis occurred as the consequence of excessive government spending, insufficient revenue from taxes, reliance on foreign borrowing, and insufficient restructuring.

Based on the outcomes of this case, Egypt shall reduce debt dependency through asset monetization, increase foreign investment via structured robust investment mechanisms such as REITs, diversify the real estate market as well as enhance transparency and investor confidence, and utilize REITs to stabilize real estate in volatile times.

Tax Structures

In Egypt, the issue of double taxation arises; under Article 46 Bis 2, investors shall pay income tax on dividends received by REIT (subject to a 5% withholding tax). Furthermore, in line with Article 47, the REIT shall pay corporate income tax on its profits before dividending them as per Income Tax Law No. 91 of 2005.

Regulatory Hurdles

The laws and regulations are ambiguous and are not fully detailed, leading to interpretations. This ambiguity led to uncertainty regarding compliance and operational requirements as well as the official websites of several authorities and entities that do not provide full documentation of all its regulations and decisions. In addition, the enforcement of regulations can differ across various jurisdictions and institutions which may cause inconsistency.

Furthermore, the lengthy licensing procedures and compliance requirements, for example, but not limit, capital requirements and financial reporting, asset valuation, and audit compliance.

Finally, the primary concern is that the absence of unambiguous, defined norms for income distribution causes uncertainty for both REIT management and investors, affecting financial planning, development plans, and investor trust in Egyptian REITs. Clear laws would enable REITs to strategy successfully, balancing investor payouts and expansion prospects.

Potential Growth of REITs

Our unique prospects, which will be utilized to achieve the potential expansion of REITs in Egypt, are as follows:

Egypt's massive population capacity and fast urbanization in big cities and newly developed areas are driving up demand for residential and commercial buildings, which REITs may leverage on for high rental returns. Furthermore, large-scale infrastructure developments improve connectivity and real estate investment attractiveness, allowing REITs to invest in high-demand locations.

Furthermore, Egypt's retail and commercial real estate expansion fuels demand for office space and shopping malls, which REITs capitalize on by investing in attractive commercial buildings.

Finally, implementing the aforementioned solutions and recommendations, such as expanding the types of REITS to include M-REITs, H-REITs, and REIT ETFs, as well as increasing REIT education, has the potential to broaden the retail investor base.

Conclusion

This article outlines the challenges, areas of improvement, and potential growth of REITs in Egypt, as well as comparative systems and case studies; I would like to highlight that our state is unique and has huge opportunities to utilize, the capital market to achieve a potential growth of REITs, utilize a most important tool, which is Artificial Intelligence ("**AI**") tools to estimate the issues and knowhow develop them to attract more investors even if international or national. In this regard, REITS authorities and entities have to provide a database of the aforementioned to enable AI technologies to provide us with accurate concerns and strategies.

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