REAL ESTATE INVESTMENT FUNDS GAIN REGULATORY CLARITY IN INDONESIA

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The Indonesian Financial Services Authority (*Otoritas Jasa Keuangan* – "OJK") issued OJK Regulation No. 64/POJK.04/2017 ("Regulation 64") on 22 December 2017 with the objective of increasing the prevalence of real estate investment funds in the form of collective investment contracts ("Real Estate CICs") in the Indonesian market. OJK acknowledged that since the issuance of the first set of regulations on Real Estate CICs in 2007 the utilisation of such investment vehicle has not been significant. Regulation 64 revoked and replaced four existing regulations on Real Estate CICs. It is hoped that by consolidating the regulations applicable to Real Estate CICs, the different players involved in setting up and administering Real Estate CICs will find it easier to understand the applicable regulations. The new regulation came into force on 22 December 2017 and we have already noticed an increase in interest in this particular type of investment fund. We set out below a summary of the key principles in Regulation 64.

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WHAT IS A REAL ESTATE CIC AND WHO ARE THE PLAYERS INVOLVED?

A Real Estate CIC is essentially an investment vehicle whereby funds are raised from investors to be invested in real estate assets, real estate-related assets, and/or cash and cash equivalents. It is managed by an investment manager and a custodian bank, which enter into a collective investment contract with the investors. In exchange for their funds contribution, the investors in a Real Estate CIC are issued participation units which reflect their interest in the fund.

Regulation 64 allows Real Estate CICs to hold the relevant assets through special purpose companies, provided certain conditions are met. For instance, 99.9% of the shares in the special purpose company must be owned by the Real Estate CIC and the collective investment contract must set out the policies applicable to the incorporation and use of the special purpose company.

Participation units in Real Estate CICs can be marketed by way of either a public offering or private placement. It is also possible to have the participation units listed on a stock exchange.

OBLIGATIONS OF INVESTMENT MANAGERS AND CUSTODIAN BANKS

Regulation 64 prescribes certain requirements which have to be satisfied by investment managers managing Real Estate CICs. Among others, such investment managers must have an investment committee and at least two employees with expertise, and at least five years of experience, in investment management.

A number of obligations are imposed on investment managers by the regulation. On the administrative side, the assets of a Real Estate CIC must be held by a custodian bank on behalf of the fund and must be kept separate from the investment manager’s own assets. This is to safeguard unit holders’ interest by preventing investment managers from using the funds’ assets for their own purposes. Aside from administrative obligations, among other obligations set out in Regulation 64, investment managers also must conduct due diligence on any property and property-related asset that will form part of the Real Estate CICs they manage. In addition, managers also have reporting obligations to OJK.

The custodian bank for a Real Estate CIC plays, as to be expected, a much more administrative role compared to the investment manager. Just like the investment manager, the custodian bank also has to separate assets of the fund under its control from its own assets. The custodian bank must complete transactions by the Real Estate CIC in accordance with the investment manager’s instructions.

It should be pointed out that investment managers and custodian banks must satisfy not only obligations set out in Regulation 64 but also (where applicable) the duties and other provisions contained in the collective investment contract and the prospectus used for the marketing of the Real Estate CIC, as well as comply with other relevant regulations, such as OJK Regulation No. 12/POJK.01/2017 on Implementation of Anti-Money Laundering and Prevention of Terrorism Financing Program in the Financial Services Sector.

RIGHTS OF UNIT HOLDERS

Regulation 64 gives holders of participation units in Real Estate CICs certain rights, such as the right to obtain information on the net asset value of the Real Estate CIC and the right to vote at general unit holders' meetings. Approvals at the general unit holders' meetings must be obtained for certain actions, such as the issuance of debt securities under the prescribed conditions.

COLLECTIVE INVESTMENT CONTRACT AND PROSPECTUS

The collective investment contract is the main investment agreement for a Real Estate CIC. Regulation 64 requires such contract to contain certain provisions and satisfy the prescribed requirements. For instance, the collective investment contract must provide for the allocation of costs between the investment manager, custodian bank, and unit holders.

Regulation 64 stipulates that a prospectus with the most updated information must be provided when marketing Real Estate CICs, and such prospectus must be drafted in such a way in order to provide for complete, sufficient, objective, and clear information that is easy to understand.

AFFILIATED PARTIES

Regulation 64 generally prohibits affiliation between the investment manager and the custodian bank of a Real Estate CIC. The regulation also requires investment managers and custodian banks to disclose their affiliates in the collective investment contract.

Regulation 64 allows an investment manager to (i) purchase real estate assets from a seller that is affiliated to the investment manager or (ii) purchase securities issued by a party that is affiliated to the investment manager or involved in the formation and/or management of the Real Estate CIC, provided that (a) the purchase transaction must be carried out on an arm's length basis independently and at a reasonable price and (b) the investment manager must disclose information on the purchase (whether directly or indirectly) in the prospectus of the Real Estate CIC.

TAX REFORMS SUPPORTIVE OF THE DEVELOPMENT OF REAL ESTATE CICS

The Indonesian central government has been keen to accelerate the development of Real Estate CICs to absorb the funds brought onshore under the recent tax amnesty program. To achieve this objective, other than issuing Regulation 64, the central government has also issued regulations to make Real Estate CICs more attractive from a tax perspective.

In late 2015, the tax on dividends received by investors of Real Estate CICs using special purpose companies was removed. Since then, it has also been possible for Real Estate CICs to apply for a refund of the value-added tax (*pajak pertambahan nilai*) they have paid for their property purchases, subject to the satisfaction of certain requirements. In 2016, the central government issued another set of regulations to reduce the income tax rate payable by those who sell their properties to Real Estate CICs from 5% to 0.5%. At present, the central government is still working on incentivising the local governments to reduce the rate of duties applicable to acquisition of land and building rights (*bea perolehan hak atas tanah dan bangunan* or *BPHTB*) to 1% to make Real Estate CICs even more attractive, but is facing some resistance from the local governments in implementing this planned favourable tax treatment.

FUTURE IMPACT

While Real Estate CICs are prevalent in more mature Asian markets such as Singapore and Hong Kong, only a handful can be found in the Indonesian market today. The consolidation of past regulations applicable to Real Estate CICs under Regulation 64 will hopefully simplify the regulatory landscape and make it easier for investment managers and custodian banks to understand their roles and obligations. With this improved regulatory clarity and the increase of available onshore funds following Indonesia's recent tax amnesty program, and given the growing number of significant real estate projects in Indonesia, we expect to see more Real Estate CICs in the Indonesian market in the coming years, especially if the government is successful in reducing the tax rates applicable to Real Estate CICs further.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

DAVID DAWBORN
PARTNER, JAKARTA

+62 21 3973 6102
David.Dawborn@hsf.com

VIK TANG
PARTNER, JAKARTA

+62 21 3973 6118
Vik.Tang@hsf.com

VISKA KHARISMA FAJARWATI
PARTNER (HISWARA BUNJAMIN & TANDJUNG), JAKARTA
+62 21 3973 8000
viska.kharisma@hbtlaw.com

MICHELLE VIRGIANY
SENIOR ASSOCIATE, JAKARTA
+62 21 3973 6117
michelle.virgiany@hsf.com

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