Closed-end mutual real estate funds as an investment management tool

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Abstract. The article deals with closed-end mutual real estate investment funds which can be used as a tool for attracting and managing financial resources of construction companies. The issues of formation of the Russian investment fund market are analyzed. The current trends and changes in the legislation on the construction industry and mutual investment funds are described. The specificity of raising funds through the real estate investment funds is revealed and factors that will affect individual projects in the real estate sector implemented through the use of closed-end real estate investment funds are determined.

1. Introduction

The transition to the market economy entails a decreasing role of the government in many industries. The development of various forms of investment is determined by the emerging need to attract additional financial resources.

Within the financial system of any country, one of the ways to accumulate investment resources is public [1, 2] and commercial funds. The fund helps to use financial resources for solving business problems. The evolution of the investment process contributed to the classification of funds by various criteria. Of great importance are investment funds.

Investment funds are a way to attract financial resources and direct them to the promising sectors of the economy. In particular, such a mechanism is used in the real estate market of the Russian Federation. It is represented by mutual investment funds.

A new institution for the Russian stock market is mutual investment funds (MIFs) which were created by Presidential Decree No. 765 "On additional measures to improve the efficiency of the investment policy of the Russian Federation" of July 26, 1995. These funds are created to intensify the investment activity and attract investors [3].

According to Article 10 of Federal Law No. 156-FZ "On Investment Funds" of November 29, 2001, mutual investment funds are property objects transferred by founders of trust to be managed by management companies. This property should be combined with the property of other founders of trust, and property obtained during the management process. The mutual investment fund is not a legal entity, and the contribution of its shares to the MIF is certified by investment shares. The investment shares are issued by management companies which manage property of the mutual fund [4].
Property management involves investing the funds in various assets. Only a company that has an appropriate license issued by the Bank of Russia is allowed to invest in the fund. The management company is an institutional investor in the securities market; it operates on a qualified basis and belongs to the group of collective investors [5].

The composition and structure of assets are recorded in the investment declaration and determine the type and category of funds. According to Federal Law No. 156-FZ, there are the following types of mutual funds determined by the terms of redemption of shares.

**Table 1.** Types of mutual funds under the terms of share buyback.

| Type      | Features                                                                                                                                 |
|-----------|-------------------------------------------------------------------------------------------------------------------------------------------|
| Open-end  | Shareholders are entitled to make calls on shares on any working day. It is necessary to write a statement or conclude an agreement, which will be considered within a few days. It is convenient for investing a small amount for a short time. |
| Closed-end| Shareholders have no right to make calls on their shares before the end of the operation period, except where otherwise is provided by law.          |
| Interval  | Shareholders have the right to withdraw from funds only during certain periods (intervals) established by the fund management rules. This allows the management company to effectively invest the funds without fear of a withdrawal of financial resources. |
| Stock     | Shareholders may require an authorized person to sell their shares on the exchange market on any business day.                               |

In Russia, the most popular funds are closed-end mutual investment funds (CMIF). The first closed-end real-estate investment fund appeared in 2003. The statistical data demonstrate a stable advantage of closed-end mutual funds among other types of mutual funds [6].

**Table 2.** Dynamics of development of mutual funds in Russia.

| Type        | 30.09.2015 | 30.09.2016 | 30.09.2017 | 30.09.2018 |
|-------------|------------|------------|------------|------------|
| Open-end    | 372        | 353        | 331        | 303        |
| Closed-end  | 1016       | 1135       | 1136       | 1111       |
| Interval    | 48         | 46         | 37         | 42         |

2. Closed-end mutual real estate investment funds

Closed-end mutual investment funds are created to implement a specific investment strategy, the term for raising funds is 3-15 years. Within this type of funds, attempts are made to invest in real estate objects.

CMIFs are created to finance the construction of real estate objects and acquisition of existing real estate objects for their subsequent lease ("rental" funds).

Real estate funds are aimed to attract investments in real estate projects. Real estate objects have always been one of the most demanded investment objects, occupying a significant share in the investment portfolio of the wealthiest investors, despite the fact that the real estate market is quite specific [7, 8, 9]. However, until the end of the 1950s, real estate investments were direct. With the emergence of the first real estate funds in 1960 in the USA, Australia, Southeast Asia and Europe, portfolio investments in the real estate market have been competing with investments that involve the direct purchase of real estate objects.

Closed-end mutual funds are an effective investment instrument with a high potential return capable of diversifying the portfolio of any investor. On the other hand, these funds can be viewed as a way to attract and manage financial resources for construction companies. Investment of small amounts of
money and minimal tax payments attract investors. The shareholder's investment income is taxed only when the profit is distributed.

Various real estate funds differ in purposes for which money is attracted. In particular, funds are created to manage office centers, shopping and residential facilities. Management companies lease the constructed premises or provide trust management services for hotel real estate objects [10]. The real estate construction funds are designed to attract financial resources for construction purposes.

The demand for closed-end real estate mutual investment funds is due to the amendments to Russian legislation. In July 2018, amendments to the Federal Law No. 214-FZ “On Participation in Construction of Apartment Buildings” of 30.12.2004 came into force, tightening the requirements for developers [11]. From July 1, 2019, new rules established the need for developers to open escrow accounts to store shareholders' money in the bank. The developer receives these financial resources only after commissioning the house. The current situation stimulates the search for additional sources of investment inflows by subjects of the construction industry, because the implementation of construction projects has become more expensive.

Raising financial resources through the real estate funds has its own specifics. An investor has no share in the facility under construction confirmed by the share participation agreement. He becomes an owner of the security-investment share, while there is no legal connection between the share and the object in the facility under construction. However, the subsequent management of such a fund by a professional management company can increase the investment results. This format of relations is convenient because the construction company works with one intermediary in the financial market rather than with a large number of owners. Currently, this structure has one of the best tax regimes. The fund is not a legal entity and therefore is exempt from the income tax.

Ordinance No. 4129-U “On the composition and structure of assets of joint-stock investment funds and assets of mutual investment funds” issued by the Bank of Russia in 2016 has changed the market of mutual investment funds [12]. The funds were divided into categories by the type of investors for whom the fund's investment units are intended. All mutual funds have been divided into funds for qualified and unqualified investors. The number of categories of funds was reduced to four: funds of market financial instruments; financial instruments funds; real estate funds; combined funds.

Thus, the importance of real estate funds for the financial and economic development has been emphasized by the legislator.

3. Assets eligible for investment of mutual real estate funds

Real estate funds are designed for qualified and non-qualified investors. Of great importance in improving the structure and management mechanism of mutual investment funds is the institution of qualified investors, designed to differentiate between the segment of financial instruments available to a wide range of mutual investment funds and the segment of financial instruments, in which only financially stable market participants are entitled to invest (qualified investors) [13]. However, such funds should be closed-end mutual funds. The period of implementation of new requirements provided for by Ordinance No. 4129-U is ten years. A comparative analysis of the composition of real estate funds, depending on the type of investors for whom the fund is intended, is presented in Table 2.

Table 3. Comparative analysis of the composition of real estate funds intended for qualified and unqualified investors.

| Assets                  | Real estate funds for unqualified investors                                                                 | Real estate funds for qualified investors |
|-------------------------|------------------------------------------------------------------------------------------------------------|-------------------------------------------|
| Real estate objects     | premises (residential and non-residential), including premises that are in common ownership with the share of the management company of the mutual fund determined (including in an apartment building) | any real estate object, including that which is in common ownership if the share of the MF management company is determined |
| Property rights | Other assets |
|-----------------|--------------|
| lease rights to the land plot on which the property included in the fund is located | derivative financial instruments, the underlying asset for which are interest rates, inflation rates, and exchange rates |
| property rights arising from contracts for participation in shared construction of residential and multi-apartment buildings | rights of claim under agreements concluded as a result of trust management, except for rights of claim arising from loan agreements |
| property rights arising from the ownership of the real estate object or part thereof following the completion of its construction | assets included in the MIF in connection with trust management expenses |
| property rights to the real estate object, including lease rights: rights from contracts under which the construction of real estate objects is carried out on a land plot, the lease right to which belongs to the mutual fund; rights from contracts providing for the participation in shared construction of real estate objects | design documents (construction or reconstruction) |
| property rights arising from contracts under which the real estate objects are reconstructed | certificates of bank deposit (Russian and foreign) |
| non-residential buildings, as well as premises, including those that are in common ownership with the share of the management company of the mutual fund determined | cash in rubles and in foreign currency in Russian and foreign accounts |
| single real estate complexes | Federal government securities, as well as securities issued by foreign countries |
| engineering infrastructure facilities for the maintenance of immovable property objects included in the MIF, or acquired for inclusion in the assets of the MIF | claims on a credit institution to pay the cash equivalent of precious metals at the current exchange rate |
| land plots on which real estate objects included in the assets of the mutual fund are located | |

4. Conclusion

The current form of attracting collective investments - mutual investment funds - is a dynamic branch of the financial market. The demand for closed-end mutual investment funds as a way to attract resources and a tool for real estate management may increase. Closed-end mutual funds are not the only mechanism operating at the intersection of the construction industry and the investment market in the Russian Federation. For example, all construction companies are obliged to be members of one of the self-regulatory organizations, making contributions to the compensation funds formed by these organizations. The resources of the compensation fund are managed or placed in commercial banks [14].

Being a project financing tool, closed-end real estate mutual investment funds should contribute to the solution of problems of the construction industry. Effective fund management by stock market professionals can have a positive impact on the final cost of construction, as well as increase the efficiency
of real estate objects. The transition from credit relations to cooperation based on the partnership between participants in the investment process, using the mechanism of closed-end mutual investment funds is one of the components of the successful development of construction companies and the real estate market as a whole.

Thus, the implementation of real estate projects through the investment mechanism of mutual funds has its own advantages. In this regard, the demand for closed-end real estate funds depends on the state regulation of construction and investment relations, the national economy and the dynamics of macroeconomic indicators. For the development of the economy, it is necessary to improve and stimulate the creation of closed-end mutual real estate investment funds through a whole range of measures: by reducing the minimum amount of initial investment in mutual funds, developing an agency network, reducing the threshold terms and amount of investment resources, improving the financial literacy of the population.

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