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Income trusts may soon get the respect they deserve

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Income trusts are starting to make serious headway in their march to mainstream legitimacy.

There's optimism in the trust world that the Ontario budget expected this month will deal once and for all with the long-festering issue of unlimited liability for trust unitholders.

The announcement by Dominion Bond Rating Service that it will soon rate trusts is another positive development, especially because DBRS will make its assessments available to investors on-line for free as early as next week.

In a new report, investment dealer CIBC World Markets even argues that income trusts provide a number of benefits to the Canadian economy.

Income trusts have become so popular with retail investors over the past few years that their collective market capitalization on the Toronto Stock Exchange is now a substantial $45-billion or so. Yet trusts are still a financial Rodney Dangerfield, searching for respect and wide acceptance by the Bay Street establishment.

Part of the problem for trusts, more correctly known as income funds, is the unlimited liability issue.

Many people in the income fund sector dismiss the risk of unlimited liability, but institutional investors have shied away from these securities because of a technical possibility they could be held liable should a trust go bankrupt or be involved in a costly lawsuit.

Both the Ontario and Alberta governments have been asked to introduce legislation that would limit unitholder liability in a way that would put income funds on the same level as common shares of a publicly traded corporation.

An Ontario Finance Ministry spokeswoman said that if Ontario makes the move, it will be in the budget that provincial Finance Minister Janet Ecker is to deliver by the end of this month.

Ian Bacque, director of government relations at the Canadian Institute of Public and Private Real Estate Companies, said his group has met several times on the liability issue with staff at the Ontario Finance Ministry and is optimistic the government will act.

"We've had a really good feel about the feedback," said Mr. Bacque, whose group represents several real estate investment trusts, or REITs. "They're interested, they recognize the issue."

Ontario is home to a wide variety of trusts, while Alberta is where oil and gas royalty trusts are mainly based. People in the income fund world say there's pressure on both provinces to act on the liability issue so that one doesn't gain a regulatory advantage over the other that causes some trusts to relocate.

The unlimited liability issue is the reason why Standard & Poor's decided not to make income funds part of the S&P/TSX composite index last fall. When the liability issue is settled, S&P is expected to act reasonably quickly to get income funds into the index.

"We'll be at their door the next day," Mr. Bacque said.

Breaking into the benchmark stock index for the Canadian market isn't just a résumé-building exercise for income funds.

The benefit of getting trusts into the index is that institutional investors will have to buy them as part of their index-investing activities. With indexing, investments mirror the contents of a particular stock index. This additional demand for trusts would improve liquidity, which means investors can expect firmer prices when trading income funds.

Settling the unlimited liability issue would be a major gain for income funds and their investors, but there are other developments afoot that will help as well.

The Ontario Teachers Pension Plan Board gave income funds an unequivocal vote of confidence earlier this year when it set up a new subsidiary that will hold these investments.

Another big win for investors is the decision by DBRS to offer free on-line access to its income fund stability ratings (at http://www.dbrs.com). Eight power-generating trusts will be rated to start, with other sectors being added in the months ahead.

The DBRS ratings will focus on seven areas, including asset quality, market position and financial flexibility, and then assign a rating that speaks to a fund's ability to sustain its distributions.

Ratings from Standard & Poor's and now DBRS lay the foundation for a healthier income fund marketplace by giving retail investors the means to seek out quality funds.

The CIBC World Markets report is an answer to those who have suggested that income funds are a gimmicky investment bound to explode in bubble fashion, just as technology stocks did.

It argues that income funds are a viable and useful feature of the corporate environment in Canada, and it also counters arguments that the tax advantages offered by these funds are in any way a loophole needing to be closed by the federal government.

Compared with last year's frenzy of new issues, the market for income funds has been kind of quiet in 2003.

Enjoy the calm because it's giving the income fund sector time to get its act together.

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