Islamic Real Estate Investment Trusts (iREITs)

By

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Outline

• Islamic REITs in Malaysia

• Salient features of Islamic REITs Guidelines

• Incentives and Liberalisation Measures

• Prospects of Islamic REITs
Islamic REITs in Malaysia

Malaysia has an established framework on Islamic REITs and is first to issue Guidelines for Islamic REITs in 2005.

Malaysia is first in the world to have an Islamic REIT listed on the stock exchange.

Currently, Malaysia has 3 Islamic REITs listed on the stock exchange -
- hospital REIT (Al-’Aqar KPJ REIT)- the first Islamic REIT in the world (August 2006)
- plantation REIT (Al-Hadharah Boustead REIT): (February 2007); and
- commercial building REIT (Axis REIT)-converted to Islamic REITs in December 2008.

<table>
<thead>
<tr>
<th>Number of Listed REITs</th>
<th>December 2011</th>
<th>August 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic REIT</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Total REITs</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market capitalisation (RM’billion)</th>
<th>December 2011</th>
<th>August 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic REIT</td>
<td>2.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Total REITs</td>
<td>16.3</td>
<td>19.5</td>
</tr>
<tr>
<td>% to total REITs</td>
<td>18%</td>
<td>19%</td>
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</tbody>
</table>
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Structure of an Islamic REIT

- **REITs investment Shariah Compliant?**
  - Manager
  - **Shariah Adviser**
  - **Property Manager**
- REIT:
  - **Management services**
  - **Management fees**
  - **Ownership of Properties**
- **Properties**:
  - **Maintenance and management services**
  - **Maintenance and management fees**
- **Unit holders**:
  - **Investment**
  - **Distributions**
  - **Acts on behalf of Unit holders**
  - **Trustee fees**
- **Rental Income Shariah Compliant?**
  - **Tenant**
  - **Rent**
  - **Rental payment**
  - **Net Property Income**
- **Shariah Compliant?**
  - **REITs investment Shariah Compliant?**
  - **Rental Income Shariah Compliant?**
RENTAL OF REAL ESTATE BY ISLAMIC REIT FOR BUSINESS PURPOSES

(i) Acquiring real estate with existing tenant(s)

- Shariah-compliant assessments must be carried out by the appointed Shariah adviser to assess any property to be acquired by an Islamic REIT.

- If the tenant(s) is/are found to operate non-permissible activities, the fund manager must perform additional compliance assessments.

- The fund manager must obtain the rental from each non-permissible activity operating at the property to be acquired.

- Rental from each non-permissible activity must be added to obtain the total rental from non-permissible activities.
Subsequently, to obtain the % of Shariah non-permissible activities over total Islamic REITs - must be below the 20% benchmark.

In the % exceeds the benchmark, the Shariah adviser shall advise the fund manager not to invest in the said real estate.

Please note that, an Islamic REIT is not permitted to own real estate, for example, a building, in which all the tenants operate non-permissible activities.
RENTAL OF REAL ESTATE BY ISLAMIC REIT FOR BUSINESS PURPOSES

(ii) Renting out real estate to a new tenant(s)

- The Shariah adviser must advise the fund manager not to accept a new tenant(s) whose activities are fully non-permissible.

(iii) Method for calculating the portion of rental of non-permissible activities from the total rental paid by a tenant(s) operating mixed activities (non-permissible and permissible activities):

(a) Calculation can be based on the ratio of area occupied for non-permissible activities; and
(b) For activities that do not involve the usage of space, such as service-based activities, the calculation method will be based on the *ijtihad* of the Shariah adviser.

*Ijtihad* - is the process of reasoning by Islamic jurists to obtain legal rulings from the sources of Shariah.
INVESTMENT, DEPOSIT AND FINANCING FOR ISLAMIC REIT

- An Islamic REIT must ensure that all forms of investment, deposit and financing instruments comply with the Shariah principles.

INSURANCE

- An Islamic REIT must use the *Takaful* schemes to insure its real estate.

- If the *Takaful* schemes are unable to provide the insurance coverage, then the Islamic REIT is permitted to use the conventional insurance schemes.
FORWARD SALES OR PURCHASES OF CURRENCY FOR RISK MANAGEMENT

- An Islamic REIT is permitted to participate in forward sales or purchases of currency, and is encouraged to deal with Islamic financial institutions.

- If the Islamic REIT deals with Islamic financial institutions, then it will be bound by the concept of *wa’d* or promise (only one party is obligated to fulfil his promise/responsibility). The party that is bound is the party that initiates the promise.

- However if the Islamic REIT deals with conventional financial institutions, it is permitted to participate in the conventional forward sales or purchases of currency.
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Incentives and Liberalisation Measures

Islamic REITs

- Tax exemption at REIT level (tax transparency) provided that 90% of its income is distributed. [Section 61A of Income Tax Act]

REITs Manager

- Up to 70% foreign shareholding in Islamic REIT management companies - Encourage foreign REIT management companies to set up operations in Malaysia and list their REITs on Bursa Malaysia.

- REIT Managers can invest in foreign real estates.

- Islamic REIT guidelines provide clarity for REIT Managers to operate Islamic REITs in Malaysia.
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Potentials of Islamic REITs

**Islamic REITS**

- Stability and potential value appreciation - REITs are considered among the low risk type of investments.

- Attractive income distribution – Higher return in the form of dividend as REITs are required to distribute its income to enjoy special tax incentives.

- Professional management – Properties managed by professional management companies.

- Portfolio diversification – Diversified tenant pools which reduce the risk of reliance on a single property and tenant in case of directly owning a real estate asset.
Potential Investor Base

Islamic REITs features such as Shariah compliance, capital stability and growth, liquidity and portfolio diversification has gained recognition to the following pool of investors:

- Pension and provident funds – likely major players due to tax treatment of REITs and the mandates to invest more in real estate.

- Retail and private banking – Focus on yields; thus REITs products should be able to cater to the need. (distribute 90% of income)

- Fixed return funds – takaful/insurance companies looking for safe predictable returns, low volatility and strength of the management.
Thank you
List of Shariah non-Permissible Activities

- Financial services based on riba (interest);
- Gambling/gaming;
- Manufacture or sale of non-halal products or related products;
- Conventional insurance;
- Entertainment activities that are non-permissible according to the Shariah;
- Manufacture or sale of tobacco-based products or related products;
- Stockbroking or share trading in Shariah non-compliant securities; and
- Hotels and resorts.
- Other activities deemed non-permissible according to Shariah