International REIT Experience and Islamic REITs

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& Chairman of the Malaysian REIT Managers Association

International REIT Panel
Borsa Instanbul
3rd October 2013
1. The Islamic Capital Markets
2. Islamic REITs – What they represent
3. Performance of Islamic REITs within the M REIT experience.
4. Opportunities and Challenges facing Islamic REITs
An Islamic capital market (ICM) is defined by market transactions that are carried out in ways that do not conflict with the conscience of Muslims and the religion of Islam.

There is an assertion of religious law within an ICM so that it is free from activities prohibited by Islam such as usury (riba), gambling (maisir) and ambiguity (gharar).

ICM is a component of the overall capital market. It plays an important role in generating economic growth for the country.

In Malaysia, the ICM functions as a parallel market to the conventional capital market, and plays a significant complementary role to the Islamic banking and Takaful in broadening and deepening the Islamic financial markets.
What is a REIT?

“A real estate investment trust is a listed vehicle that invests in a portfolio of income-generating properties. Rents collected from tenants, less expenses are distributed on a regular basis to provide stable yields to Unitholders”

This distributed income to Unitholders is subject to a one time withholding tax of 10% for individuals. The REIT is not taxed by the IRB.
What does a REIT Represent?

- Units in a REIT represents equity ownership

- Indirect access of large, stable estate portfolios in a tax efficient manner (This distributed income to Unitholders is subject to a one time withholding tax – 10% in Malaysia).

- Governed by a Trust Deed, the Stock Exchange and the Securities Commission regulations which define the operating procedures ensuring a high level of corporate governance.
Why Listed REITs

✓ Liquid proxy to physical assets
✓ Priced daily in the market
✓ Liquid pool of stocks
✓ Hedge against inflation
✓ Low entry
✓ Excludes Property Business risk
Earnings Profile

✓ A REIT is driven by recurring rental income

A property company seeks a combination of property sales, development profits, rental income and property investments.

Capital Structure and Cash Flow

✓ A REIT has low and defined level of retained earnings, low debt level defined by the regulators and strong cash flow from operations

A property stock has a high gearing ratio due to high capital expenditure required for property development and sometimes negative cash flow. Low dividend payouts.
Dividend Distribution Policy

✓ A REIT will distribute 90-100% of its retained earnings before tax.

* A property stock has no certainty of a dividend payout.

Risk Profile

✓ A REIT is a low risk, passive investment vehicle with a high certainty of cash flow from rentals derived from lease agreements with tenants

* A property stock has a high development and financial risk.
Corporate Governance

✓ REITs are governed by multiple layers of stakeholders - unitholders, manager, trustees and regulating authorities, ensuring that interest of minority unitholders are protected.

A property stock is often dominated by a controlling shareholder which raises conflict of interest issues with minority shareholders.
"An investment vehicle that invests or proposes to invest at least 50% of its total assets in real estate. An investment in real estate may be by way of direct ownership or a shareholding in a single-purpose company whose principal assets comprise real estate”

Note: Real estate means physical land and those human made items which are attached to the land”
(Source: SC Guidelines on REITs 2005)

Islamic REIT - “In general, an Islamic REIT is a collective investment scheme in real estate, in which the tenant(s) operates permissible activities according to the Shariah”
(Source: SC Guidelines for Islamic REITs)
Features of a Shariah Compliant REIT

✓ Structured along the lines of a unit trust with managers and Trustees

✓ Investment funds are pooled to purchase real estate assets to produce income streams.

✓ Purchasers of units are considered as beneficial owners of the purchased assets.

✓ Units can be bought or sold at market price agreeable by both sellers and buyers

✓ Negotiability of the units are not a problem from the Shariah perspective as units represent direct interest in tangible assets – a plus point for REITs
Countries with Islamic REIT Guidelines

MALAYSIA
Guidelines for Islamic Real Estate Investment Trusts were issued on 21 November 2005

✓ These guidelines as outlined by the Syariah Advisory Council (SAC) of the Securities Commission were to facilitate the establishment of an Islamic real estate investment trust (Islamic REIT).

✓ These guidelines must be adhered to by the market players in the process of establishing an Islamic REIT. It must be read together with the Guidelines on Real Estate Investment Trusts (revised on 28 December 2012)
Issued on November 21 2005

Non-Permissible rental activities must not exceed the 20% benchmark based on the total turnover or area occupied;

Not permitted to own real estate in which all the tenants operate non-permissible even if the percentage based on turnover /floor area is less than the 20% benchmark;

All forms of investments, deposits and financing must comply with the Shariah principles;

Must use the Takaful schemes to insure its real estate;

The Manager must engage a Shariah advisory panel of 3 scholars or company approved by the Securities Commission.
**Shariah rules** state tenants in Shariah compliant properties cannot be involved in the following businesses:

- The Serving, distribution and manufacture of Alcohol products
- The sale, manufacture and distribution of tobacco products
- Pork related products
- Conventional financial services based on interest (Riba). [Includes Data Centers storing conventional bank data or document storage facilities]
- Weapons or defense
- Entertainment activities not permissible under Shariah Law (e.g. casinos, cinemas- now extended to include TV stations, music distribution, magazine publications)
- Hotels and resorts
- Stock broking or share trading in Non-Shariah compliant securities
Typical REIT Structure

- **Unit holders**
  - Minimum 25%
  - Maximum 75%

- **Investors**
  - Cornerstone investors
  - Institutional funds
  - Retail

- **Vendors**

- **REIT Management Company**
  - Management Services
  - Management Fees

- **Property Management Company**
  - Services
  - Fees

- **REIT**
  - Acts on behalf of Unit holders
  - Investment in REIT Units
  - Distributions

- **Trustees**
  - Trustee Fees

- **Properties**
Typical Islamic REIT Structure

- **Vendors**
- **Investors**
  - Maximum 75%
  - Minimum 25%
  - Public Spread
- **Cornerstone investors**
- **Institutional funds**
- **Retail**

- **Unit holders**
  - Investment in REIT Units
  - Acts on behalf of Unit holders

- **REIT Management Company**
  - Management Services
  - Management Fees

- **Property Management Company**
  - Services
  - Fees

- **Shariah Compliant Properties**
  - Shariah Advisor

- **Trustees**
  - Trustee Fees
## Comparison conventional REIT/Islamic REIT

<table>
<thead>
<tr>
<th></th>
<th>Conventional REIT</th>
<th>Islamic REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shariah Committee/Advisors</td>
<td>Not needed</td>
<td>Islamic REIT must appoint a Shariah advisor to ensure Shariah compliance</td>
</tr>
<tr>
<td>Permissibility of activities</td>
<td>No restrictions</td>
<td>Only permissible activities allowed</td>
</tr>
<tr>
<td>carried out by tenants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance for properties</td>
<td>Conventional insurance with insurance companies as approved by trustees</td>
<td>If available: Islamic insurance/Takaful If unavailable: May opt for conventional insurance</td>
</tr>
<tr>
<td>Financing</td>
<td>No restrictions</td>
<td>Must be Shariah compliant</td>
</tr>
</tbody>
</table>
**Malaysia** has 3 listed Islamic REITs and one Shariah compliant REIT

- Axis REIT – Office and Industrial Assets
- Al’ Hadhara Boustead REIT – Plantations (expected to go private this year)
- Al’-Akar KPJ REIT – Hospital Assets

- KLCC REIT – stapled securities – Office, Malls & hotel assets [*It is listed as Shariah Compliant not as a Islamic REIT*]

**Singapore** has 1 listed Islamic REIT [Note Singapore has no formal Islamic REIT guidelines]

- Sabana REIT- Industrial Assets
Why Axis REIT became an Islamic REIT
Objectives of becoming an Islamic REIT

✓ To widen the investor base to include locally based Shariah Funds as well as develop investor interest from Foreign Shariah Funds.

✓ To use SUKUK as an effective means for debt funding

✓ Although Shariah compliant equities exist globally they do not come under a specific guideline rather they use the services of a Shariah Scholar who is accredited globally to “Bless” the fund.

✓ By adhering to structured guidelines it enables Axis-REIT to become the 1\textsuperscript{st} Office Industrial REIT in the world to comply with Shariah principles.
Upon conversion the share price recovered and provided an opportunity to undertake new placements and avoid substantial dilution in DPU and NAV per unit to existing unitholders.
Since the reclassification to being Shariah compliant, there was an increase in liquidity.
M REITs
Performance to date
<table>
<thead>
<tr>
<th>Trust</th>
<th>Office</th>
<th>Retail</th>
<th>Industrial</th>
<th>Hospitality</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Al-Aqar K PJ</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⭐️</td>
</tr>
<tr>
<td>Al-Hadharah</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⭐️</td>
</tr>
<tr>
<td>AmanahRaya</td>
<td>⭐️</td>
<td>⭐️</td>
<td></td>
<td></td>
<td>⭐️</td>
</tr>
<tr>
<td>AmFirst</td>
<td>⭐️</td>
<td>⭐️</td>
<td></td>
<td></td>
<td>⭐️</td>
</tr>
<tr>
<td>Atrium</td>
<td></td>
<td></td>
<td>⭐️</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Axis</td>
<td>⭐️</td>
<td></td>
<td>⭐️</td>
<td></td>
<td></td>
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<tr>
<td>Hektar</td>
<td></td>
<td>⭐️</td>
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<td></td>
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<tr>
<td>Quill</td>
<td>⭐️</td>
<td></td>
<td>⭐️</td>
<td></td>
<td>⭐️</td>
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<tr>
<td>Starhill</td>
<td></td>
<td>⭐️</td>
<td></td>
<td>⭐️</td>
<td>⭐️</td>
</tr>
<tr>
<td>Tower</td>
<td>⭐️</td>
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<tr>
<td>UOA</td>
<td>⭐️</td>
<td></td>
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<tr>
<td>CMMT</td>
<td></td>
<td>⭐️</td>
<td>⭐️</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sunway</td>
<td>⭐️</td>
<td>⭐️</td>
<td></td>
<td></td>
<td>⭐️</td>
</tr>
<tr>
<td>Pavilion</td>
<td></td>
<td>⭐️</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

- Green indicates Shariah compliant REIT
- Stars represent the different asset classes
- Healthcare, Plantation, Education, Car Parks are marked separately.
<table>
<thead>
<tr>
<th>REIT</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Total DPU up to 2012(Sen)</th>
<th>IPO Price Sen</th>
<th>% Recovery of investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Al-Aqar KPJ REIT</td>
<td>2.72</td>
<td>7.32</td>
<td>8.1</td>
<td>8.1</td>
<td>7.73</td>
<td>5.17</td>
<td>5.78</td>
<td>44.92</td>
<td>95</td>
<td>47.28%</td>
<td></td>
</tr>
<tr>
<td>AmanahRaya REIT</td>
<td>5.44</td>
<td>7.01</td>
<td>7.15</td>
<td>5.49</td>
<td>7.22</td>
<td>7.45</td>
<td>39.76</td>
<td>89.5</td>
<td>44.42%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AmFirst REIT</td>
<td>1.95</td>
<td>7.3</td>
<td>8.75</td>
<td>9.75</td>
<td>9.75</td>
<td>9.31</td>
<td>6.81</td>
<td>53.62</td>
<td>100</td>
<td>53.62%</td>
<td></td>
</tr>
<tr>
<td>Atrium REIT</td>
<td>6.5</td>
<td>8.4</td>
<td>6.95</td>
<td>8.6</td>
<td>8.53</td>
<td>8.8</td>
<td>47.78</td>
<td>100</td>
<td>47.78%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Axis REIT</td>
<td>4.7</td>
<td>12.95</td>
<td>13.63</td>
<td>15.27</td>
<td>15.8</td>
<td>16</td>
<td>17.2</td>
<td>18.6</td>
<td>114.15</td>
<td>125</td>
<td>91.32%</td>
</tr>
<tr>
<td>Al-Hadharah Boustead REIT</td>
<td>10.91</td>
<td>11.03</td>
<td>9.3</td>
<td>10</td>
<td>12</td>
<td>10</td>
<td>63.24</td>
<td>99</td>
<td>63.88%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hektar REIT</td>
<td>9.89</td>
<td>10.2</td>
<td>10.3</td>
<td>10.6</td>
<td>10.5</td>
<td>10.5</td>
<td>61.99</td>
<td>105</td>
<td>59.04%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quill Capita Trust</td>
<td>0.49</td>
<td>6.46</td>
<td>7.51</td>
<td>7.68</td>
<td>8.03</td>
<td>8.3</td>
<td>8.38</td>
<td>46.85</td>
<td>84</td>
<td>55.77%</td>
<td></td>
</tr>
<tr>
<td>Starhill REIT</td>
<td>3.45</td>
<td>6.7</td>
<td>6.89</td>
<td>6.91</td>
<td>6.49</td>
<td>7.64</td>
<td>7.18</td>
<td>45.26</td>
<td>96</td>
<td>47.15%</td>
<td></td>
</tr>
<tr>
<td>Tower REIT</td>
<td>5.34</td>
<td>8.48</td>
<td>9.35</td>
<td>10</td>
<td>10</td>
<td>10.85</td>
<td>11.52</td>
<td>65.54</td>
<td>107</td>
<td>61.25%</td>
<td></td>
</tr>
<tr>
<td>UOA REIT</td>
<td>8.5</td>
<td>8.52</td>
<td>10.03</td>
<td>11.5</td>
<td>8.97</td>
<td>9.83</td>
<td>10.48</td>
<td>67.83</td>
<td>115</td>
<td>58.98%</td>
<td></td>
</tr>
<tr>
<td>Capitamalls Malaysia</td>
<td>3.4</td>
<td>7.87</td>
<td>8.44</td>
<td>19.71</td>
<td>98</td>
<td>20.11%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sunway REIT</td>
<td>3.26</td>
<td>6.8</td>
<td>6.28</td>
<td>16.34</td>
<td>88</td>
<td>18.57%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pavilion REIT</td>
<td>6.87</td>
<td>6.87</td>
<td>88</td>
<td>7.81%</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
Capital Gains Since Listing (as of March 30 2013)

Source: The Financial Daily & company data
Premium/Discount to Net Asset Value (NAV) (as of March 30 2013)

Source: The Financial Daily & company data
Distribution Yields (as of May 8 2013)

Ave 6.4%

10 year Govt Bond 3.4%

Source: The Financial Daily & company data
Market Capitalization (as of May 8 2013)

Total Market Capitalization – RM26.365 Billion

Source The Financial Daily & company data
The Opportunities and Challenges faced by Islamic REITs
Challenges taking Islamic REITs Global

✓ Majority of global assets that are Shariah compliant reside in the developed world.

✓ Hospitals, Industrials and plantations/farms and some office assets are the available grouping which can form very large liquid funds.

✓ Yields are currently compressed and so may not resonate well with the investment community.

✓ These countries in the developed world do not have an Islamic financial market of any scale and so it would be hard to get Islamic finance for such vehicles.

✓ Takaful is not readily available.

✓ Marketing will be difficult as the assets and yields do not attract the GCC funds.
Counties in the gulf sometime have different rules on compliance

✓ Some gulf countries have a zero - 5% tolerance to non-permitted activities (*Malaysia has a 20% tolerance*).

✓ Some don’t require total debt to be Islamic (limited to 1/3 of total debt may be conventional) (*Malaysia Does require this*).

✓ Some don’t require insurance to be Takaful if unavailable.

✓ Some jurisdictions require that if the tolerance limit is 5% then that income must subject to “Purification” – that is has to be donated to charities.

✓ Review can be on a quarterly basis.
Issues affecting Malaysia’s Islamic REIT industry

- Asset availability are confined to Office, Industrial, Plantation and Hospitals. Popular assets like Malls, Hotels and Offices with conventional banking and Insurance tenants are excluded.

- GCC investors are not keen on Industrial and Hospital assets.

- Scholars are in short supply as they need to have a banking and Shariah background and be conversant in both Arabic and English.

- It takes time to train new scholars.

- Such assets are not available yet in the Gulf States.

- A narrow interpretation of Shariah rules may stifle growth.
Thank you