

ISLAMIC REAL ESTATE INVESTMENT TRUSTS

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Definition

Various definitions of REITs:

- A security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages.

<http://www.investopedia.com/terms/r/reit.asp>

- A corporation or trust that uses the pooled capital of many investors to purchase and manage income property (equity REIT) and/or mortgage loans (mortgage REIT). REITs are traded on major exchanges just like stocks

<http://www.investorwords.com/4158/REIT.html>

REIT: Definitions From Guidelines

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- REIT - “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 Syariah”

Source: SC Guidelines for Islamic REITs

Islamic REIT Vis-à-vis Conventional REIT?

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- Fundamentally – not much difference
 - Objective, administration and structure of an Islamic REIT – very similar to Conventional REIT
 - Key difference – how the incomes of the Islamic REIT are derived and how the fund is being managed, e.g:
 - type of tenants; and
 - proportion of rental income derived from the tenants
- Islamic REIT – tenants in a property acquired must operate in businesses that comply with Syariah principles
 - Conventional REIT – no such requirement
 - Islamic REIT – fund must be managed in Shari`ah compliant manner
 - Conventional REIT – no such requirement

Type of Real Estate Investments

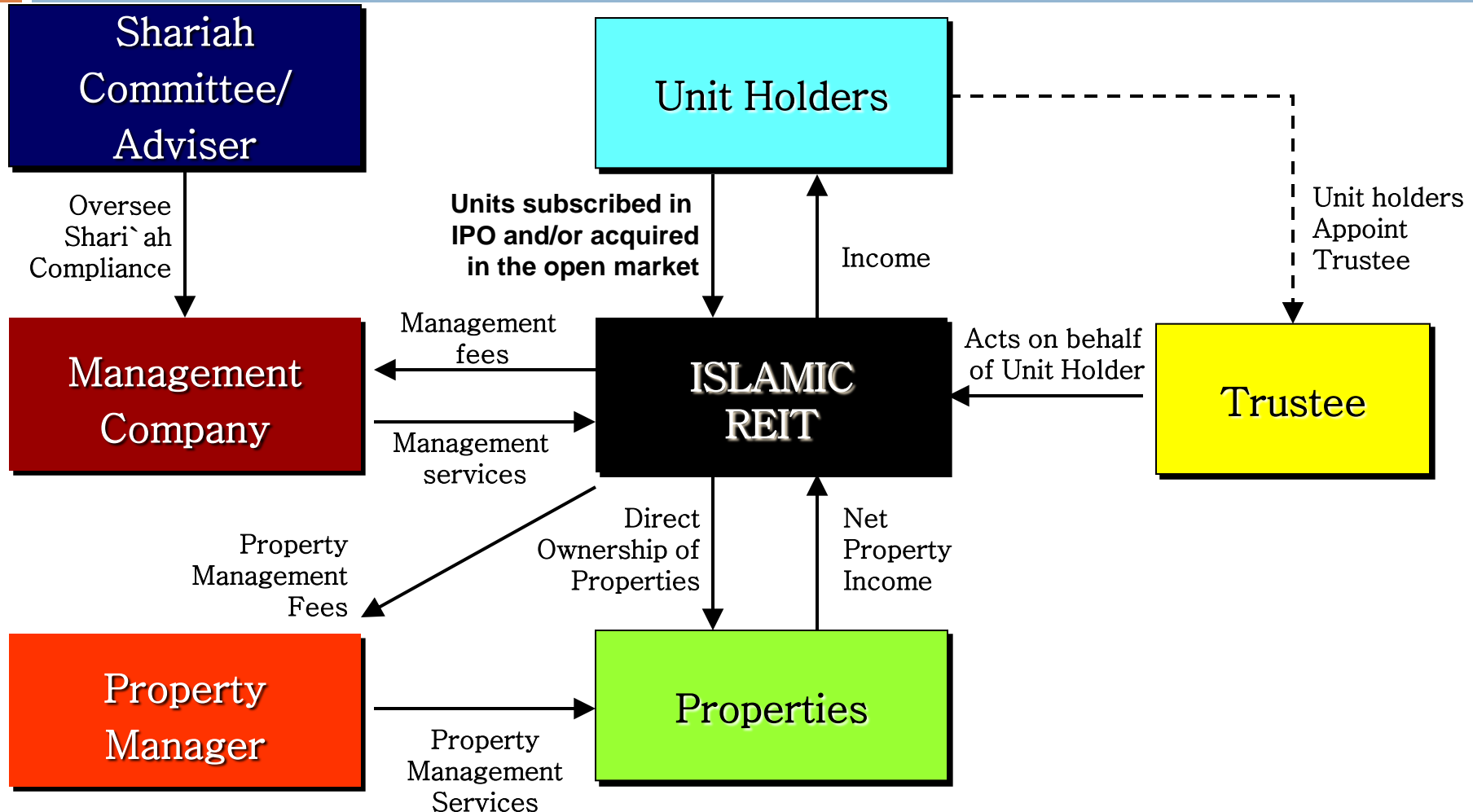
- ◆ **Direct Investments**
- ◆ **Indirect Investments or Real Estate Funds**
- ◆ **Time-Share concept**
- ◆ **Sale & Leaseback funds**
- ◆ **Land Banking**
- ◆ **Real Estate Securities**
- ◆ **Real Estate Investment Trusts (REIT)**

Structuring And Managing Islamic REITs

- The structuring of Islamic REITs will be the same like the conventional REITs except for the Shariah Guidelines and principles that must be followed in:
 - 1) Contracts and principles used.
 - 2) Managing the REITs:
 - Utilization of the real estate must be Shari`ah compliant, including tenancies & sub-tenancies
 - Financing of the acquisition / development of the real estate should be Shari`ah Compliant
 - Investment of cash / liquidity must be made in Shari`ah compliant instruments
 - Insurance scheme for protecting the real estate should also be Shari`ah compliant

Structure of an Islamic REIT

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GUIDELINES ON ISLAMIC REITs (Malaysia)

- On 21 November 2005, SC further released the Guidelines for Islamic Real Estate Investment Trust, in an effort to facilitate further development of new Islamic capital market products.
- The first Islamic REITs Guidelines in the world
- An Islamic REIT must comply with both Guidelines – the Guidelines for Islamic REITs (November 2005) & the general SC Guidelines on REITs (January 2005)

Singapore & Dubai

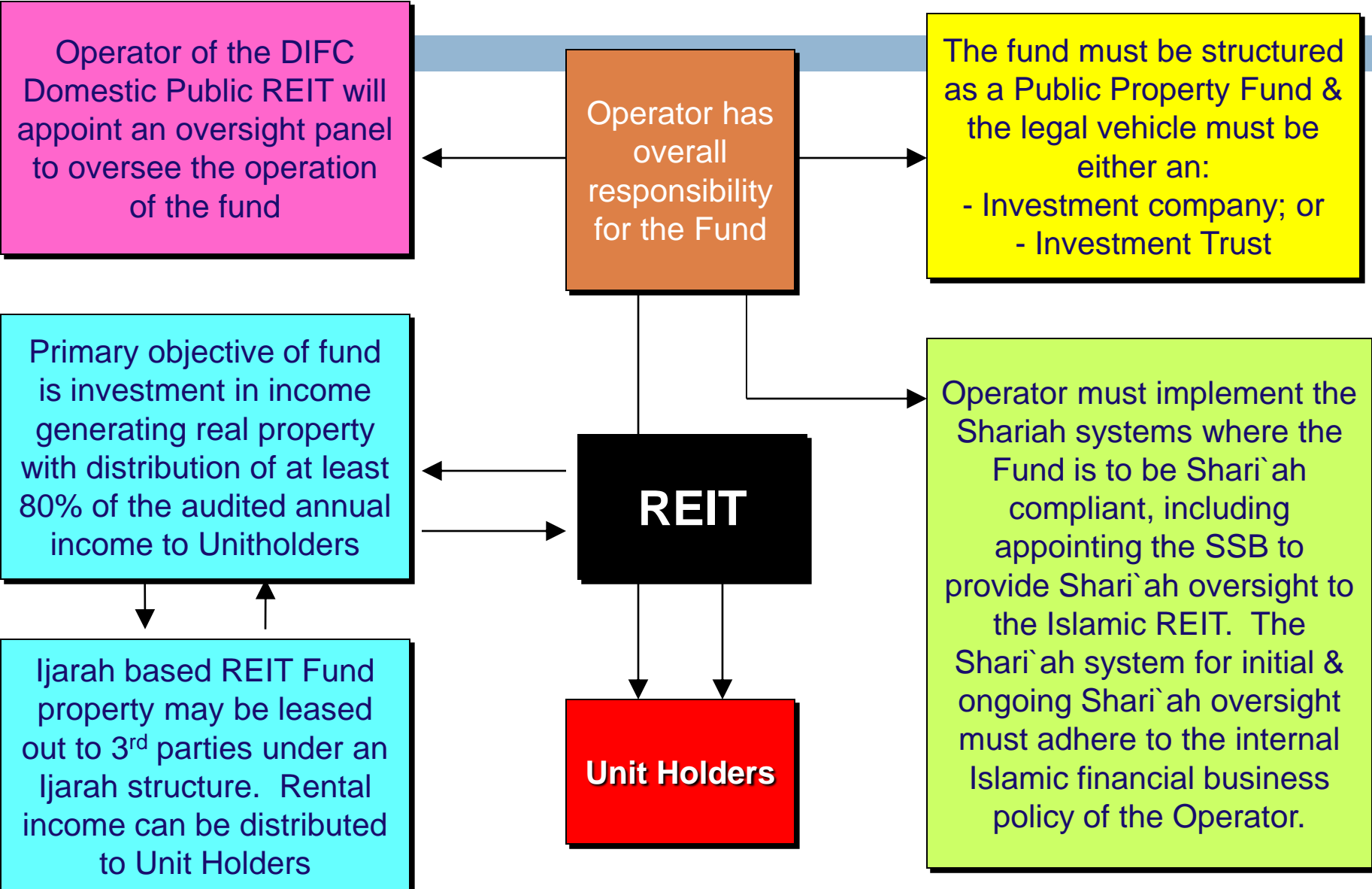
- In Singapore, there is no Shariah framework issued by regulator on Islamic REITs.
- Only legal framework applicable to both conventional and Islamic REITs
- The Shariah framework on Islamic REITs is to be determined by the respective Shariah Board of the Islamic REITs
- The same position is also adopted by DIFC
- In Singapore, there is Sabana Shariah Compliant REITs.
- From here, we can investigate the Shariah requirement of Islamic REITs

Islamic REITs in / from DIFC

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- Although there is no specific DFSA module for Shari`ah compliant REITs, the regulatory regime permits REIT structures to be offered in or from DIFC
- What is important is that the REIT operator / manager must implement the Shari`ah system to oversee Shari`ah compliance of the REIT, including:
 - ▣ Appointment of SSB
 - ▣ Initial & on-going Shari`ah oversight
 - ▣ Adherence to the internal Islamic financial business policy of the operator

DFSA REIT Structure with an in-built Shari`ah System



Shariah Parameters of i-REITs

An i-REIT investments, operations & management must be monitored, reviewed and approved by the appointed Shariah Adviser. The areas of concern are:

**Rental of
Real Estate**

**Investment,
Deposit
& Financing**

**Insurance/
Takaful**

**Risk
Management**

Comparison Between Shariah Parameters in Islamic REITs in Malaysia and Singapore

ISSUES	MALAYSIA (AS PER GUIDELINES)	SINGAPORE (AS PER SABANA SHARIAH COMPLIANT REITS)
Acquiring New Assets (with existing tenant)	<ul style="list-style-type: none"> -Tenants must operate permissible activities -If some tenants operating non permissible activities: should not exceed 20% of the i-REIT turnover -Not allowed to acquire any property which operates 100 % non Shariah compliant 	<ul style="list-style-type: none"> - If mixed activities, must obtain prior approval from Shariah Committee. - No mention about percentage
Continuous Rental	<ul style="list-style-type: none"> -Not allowed to any single tenant whose activities are non permissible (100% must be Shariah Compliant) -Mixed activities: Calculation will be based on the ratio of area occupied for non-permissible activities to the total area occupied 	<p>Non permissible activities < 5.0% per annum of the Gross Revenue</p>

Cont'd

ISSUES	MALAYSIA (AS PER GUIDELINES)	SINGAPORE (AS PER SABANA REITS)
Financing, investment and deposit facilities	Must be Islamic	<p>Must be Islamic, if not available / viable, can do conventional but with permission from Shariah Advisers, subjected to three ratios:</p> <ul style="list-style-type: none">i- total interest-based debt to trailing 12-month average NAV ratio must be less than 33.0%ii- sum of cash and interest-bearing securities, must be less than 33.0%.iii- In addition to the above, all accounts receivable, must be less than 33.0%. <p>-If breached, the manager shall bring it back within the threshold within a period of two reporting quarters or six months, whichever is sooner.</p> <p>Shall get approval from the Shariah Committee to accept banking facility from a non-Islamic financial institution, even if the above ratios are not breached</p>

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ISSUES	MALAYSIA (AS PER GUIDELINES)	SINGAPORE (AS PER SABANA REITS)
Takaful /Insurance	Must be Islamic, if not available / viable, can do conventional but with permission from Shariah Advisers	Same
Risk Management Solution	<ul style="list-style-type: none">- Only for hedging purposes- Must be Islamic, if not available / viable, can do conventional but with permission from Shariah Advisers	Same
Cleansing process	No mention	the net amount of non permissible income (after deduction of applicable expenses) before distribution of net income

Asset Allocation

- Shopping Complex / mall
- Retail Properties
- Warehouse, Industrial Properties & Storage
- Offices
- Accommodation
- Entertainment Centre
- hotels & resorts
- Education & research
- Hospital / Health Centre

- Shariah Permissible activities need to be ascertained

Prospect and Opportunities in Islamic REITs

- Compared to other assets classes, REITs are considered among the low risk type of investments
- Besides that, it also provides investors with various benefit.
- Among others are:
 - ▣ **Income Distribution:** Higher certainty of income stream in form of dividends as the REIT is required to distribute its income to enjoy the special tax incentive
 - ▣ **Portfolio Diversification:** REITs typically own multi-property portfolio with diversified tenant pools which reduce the risk of reliance on a single-property and tenant in case of directly owning a real estate asset
 - ▣ **Participation in property market:** Initial capital outlay is small . Opportunity for retail investors to own investment grade assets
 - ▣ **Professional management:** REITs allow investors the opportunity to buy into properties managed by professional management companies

Challenges For Islamic REITs

- In some jurisdiction, the regulatory and taxation framework is not facilitative
- REITs are not free from risk:
 - ▣ Risk relating to the properties.
 - ▣ Risk Relating to the management
 - ▣ Risk Relating to the tenancy and sub tenancy
 - ▣ Risk relating to external issues
 - ▣ Etc.
- All these risks may effect the performance of Islamic REITs

Criteria for successful Islamic REITs

Quality Islamic REITs:

- ❑ Quality underlying real estates with sustainable growth prospects
- ❑ Asset diversification
- ❑ Long-term investment planning – growth by asset value enhancement & further asset acquisition

Quality Management:

- ❑ Result-oriented manager
- ❑ Transparency to investors
- ❑ Independence of management (outset & ongoing)
- ❑ Strong management team
- ❑ Effective Shari`ah governance

Way Forward

- Ensuring conducive environment and sufficient legal, regulatory and taxation framework to entice originator (property owner), investors, arranger and etc., to participate actively in this asset class.
- Asset class: Variation and Quality asset
- Quality management
- Facilitative in incorporation and listing of Islamic REITs: Legal and taxation framework
- Shariah Framework must be clear and transparent.



**THANK YOU
WASSALAM**