ISLAMIC REAL ESTATE AND INVESTMENT TRUSTS (ISLAMIC REITS) A PROMISING ASSET CLASS FOR WEALTH MANAGEMENT

Islamic REITs have a natural alignment with Shariah principles - which emphasize real-sector investments - and there is considerable opportunity for financial institutions to introduce Islamic REIT products to the market.

Malaysia has a clear advantage in this regard thanks to a comprehensive and clear regulatory framework and incentives that provide clarity to managers interested in operating Islamic REITs.

Since Malaysia's innovative launch of the world's first Islamic REIT in July 2006, the asset class has registered encouraging growth and presents strong prospects to augment the Islamic wealth management practices globally.

13 December 2013

MIFC®
MALAYSIA INTERNATIONAL
ISLAMIC FINANCIAL CENTRE

Islamic Real Estate and Investment Trusts (Islamic REIT) – A promising asset class for wealth management

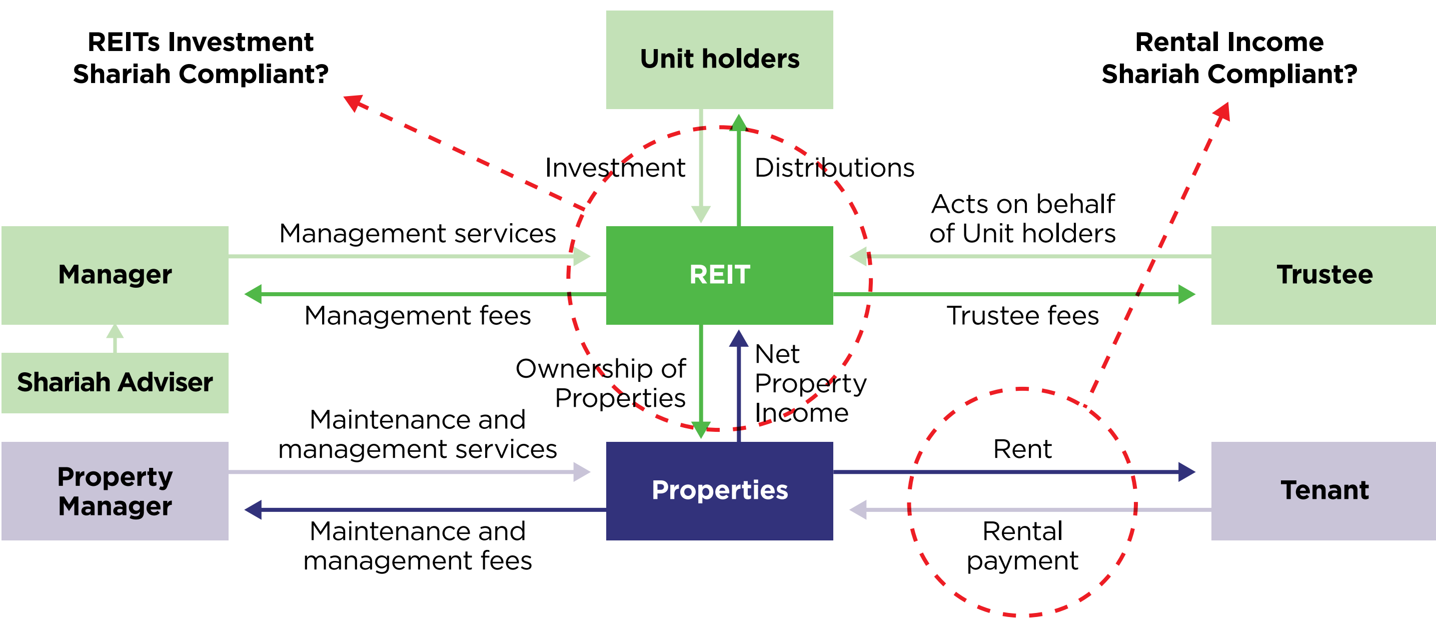
Since Malaysia's innovative launch of the world's first Islamic REIT in July 2006, the asset class has registered encouraging growth and presents strong prospects to augment the Islamic wealth management practices globally.

What are Islamic REITs?

The key feature of Islamic REIT is that the incomes and fund management of the Islamic REIT must observe the principles of Shariah. According to the Securities Commission Malaysia (SC) 2005 Guidelines on Islamic REITs, "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". This would involve acquisition and leasing of real estate (including tenancies and sub-tenancies), where the activities and operations are Shariah-compliant. Examples of impermissible activities/operations include conventional banking services, gambling and casino operations, sale of liquor and non-halal food items among others. In case of mixed tenants operating mixed activities (Shariah-compliant and non-compliant activities), the proportion of rentals from the operation of non-permissible activities to total turnover of the Islamic REIT in any current financial year must not exceed 20%. A property where all tenants operate only non-permissibe activities cannot be included in the REIT.

Structure of an Islamic REIT

Source: Securities Commission Malaysia (2012)



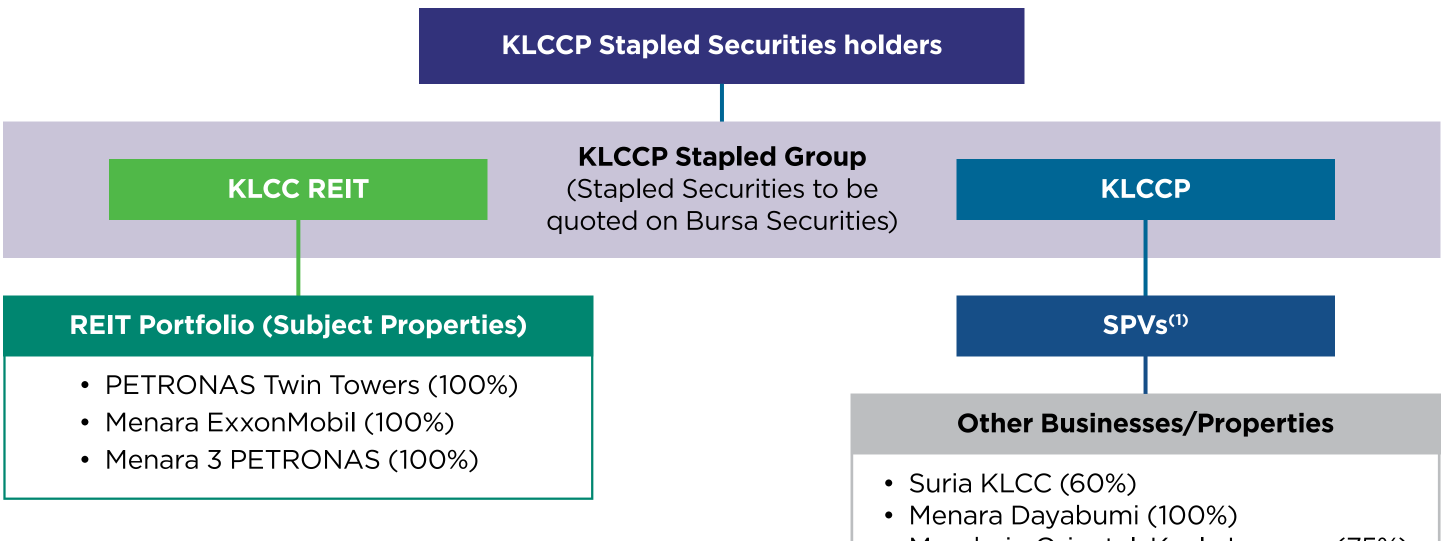
Malaysia's experience as the pioneer of Islamic REITs

In November 2005, the Shariah Advisory Council (SAC) of the SC released guidelines for Islamic REITs which paved way for the establishment of the first Islamic REIT in the world on 28th June 2006 called the Al-Aqar KPJ REIT. The Al-Aqar REIT invested in 6 hospitals with the market value of the properties estimated at USD138mln. Malaysia introduced a second Islamic REIT in the subsequent year when on 8th February 2007, Al-Hadaharah Boustead REIT, listed on the main board of Bursa Malaysia. The Al-Hadarahah Boustead REIT underlying assets were plantation estates and the initial investments were valued at USD136mln. In December 2008, Malaysia introduced a third Islamic REIT called the AXIS REIT, which is the the world's first Islamic industrial/office REIT. AXIS REIT was originally established in August 2005 as a conventional REIT. Subsequently, it was restructured according to the SC's Islamic REIT guidelines to be classified as a Shariah-compliant REIT in December 2008.

This year in May 2013, Malaysia introduced the KLCC Real Estate Investment Trust (KLCC REIT), which is the the world's first Shariah-compliant stapled REIT. KLCC REIT is currently Malaysia's largest REIT with a market capitalisation of RM10.65bln as at end-Nov 2013. Stapled REITs are investment vehicles which include two or more separate entities 'stapled together' to trade using a single new financial instrument. KLCC REIT staples together the existing shares of KLCC Property Holdings Bhd (KLCCP) and units of KLCC REIT which consist of Kuala Lumpur City Centre's three prime assets: Petronas Twin Towers, Menara 3 Petronas and Menara ExxonMobil. The stapled REIT trades on Malaysia's main bourse, Bursa Malaysia.

Structure of Stapled KLCC REIT (Shariah-compliant)

Source: Bursa Malaysia



(1) Assets and/or businesses held via SPVs.
(2) Includes vacant land (Lot D1), and parking and facilities management.
(3) A wholly-owned subsidiary of KLCCP which is proposed to be established and shall act as the management company of KLCC REIT.

ISLAMIC REAL ESTATE AND INVESTMENT TRUSTS (ISLAMIC REITS) A PROMISING ASSET CLASS FOR WEALTH MANAGEMENT

As at end-November 2013, there are a total of 4 Islamic REITs in Malaysia bearing a market capitalisation of RM14.39bln, representing 42.6% of the total REITs industry in Malaysia. During 11M13, Islamic REITs in Malaysia generated an average return of 13.4%[1].

The Malaysian regulatory framework ensures all REITs are governed by multiple level of stakeholders to ensure maximum investors protection. REITs in Malaysia fall under the regulatory purview of the SC and also under the purview of Bursa Malaysia Securities Berhad

Malaysian Islamic REITs Industry

No. of REIT	End- Nov 2013	Dec 2012
Islamic REIT	4	3
Total Industry	17	16
Market Capitalisation (RM billion)		
Islamic REIT	14.39	3.5
Total Industry	33.75	24.6
% to Total Industry	42.6%	14.2%

Source: Bloomberg, Securities Commission Malaysia, KFH Research Limited

The Malaysian Islamic financial landscape provides enabling environment through clarity of regulation and incentives to support the development of Islamic REITs. The guidelines released by SC in November 2005 provides clarity for REIT Managers to manage Shariah compliant REITs and offer it as a new asset class for wealth management to investors across the globe. The guidelines allow up to 70% foreign shareholding in Islamic REIT management companies in Malaysia. Furthermore, REIT Managers in Malaysia can also invest in foreign real estates. Meanwhile, 2007 onwards, Section 61A of Income Tax Act extends tax exemptions to at REIT level provided that 90% of the REIT income is distributed to investors.

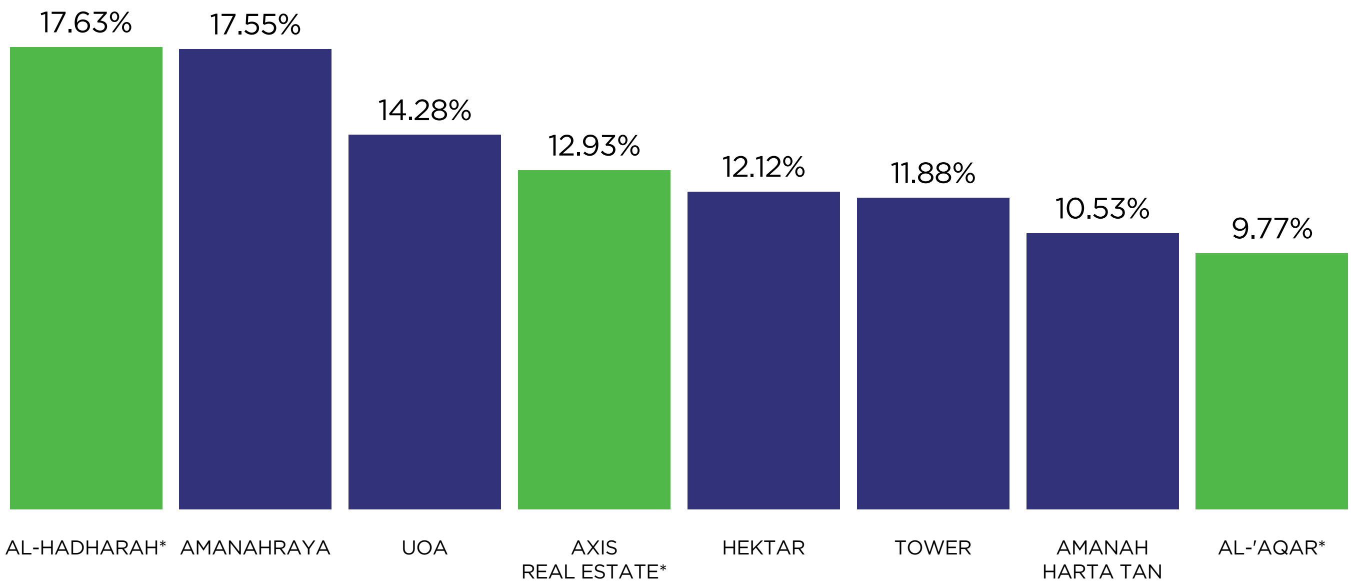
if the REIT is listed on the country's stock exchange. An Islamic REIT must additionally have in place a Shariah advisory committee to oversee the Shariah compliance of the REITs operations. A typical Islamic REIT in Malaysia includes the following stakeholders:

- Investors/Unit Holders
- REIT Manager
- Shariah Advisory Committee
- Trustee
- Regulatory Authorities
  (SC and also Bursa Malaysia if listed)

[1] Bloomberg, KFH Research Limited. The average return exclude the KLCC REIT since it has been newly launched in May 2013.

Top 8 Malaysian REITs and Islamic REITs by Total YTD Returns (end-Nov 2013)

*Islamic REITs
Source: Bloomberg, KFH Research Limited



Experience of Islamic REITs in Other Countries

Following Malaysia's leadership, other countries including Singapore, Kuwait, Bahrain and United Arab Emirates have also introduced Islamic REITs in their financial markets.

Kuwait

Kuwait launched the first Islamic REIT in 2007 known as the Al Mahrab Tower REIT which has the Al Mahrab Hotel tower of Makkah, Saudi Arabia as the primary income generating asset. The Islamic REIT is estimated to have a market capitalisation of approximately USD100mln in 2013 while the initial prospectus indicated the REIT is expected to generate an internal rate of return of 24% for the investors. The REIT however is not listed and remains as a private REIT in Kuwait.

Bahrain

The Financial Institutions Supervision Directorate of the Central Bank of Bahrain (CBB) authorised the first Islamic REIT in Bahrain in June 2009. Within the same year, the Bahraini asset management company Inovest launched the Inovest REIT with a fund of BHD30mln (USD79.8mln) with the objective of acquiring income-generating properties in the Gulf Cooperation Countries (GCC). The Islamic REIT was originally estimated to earn an annual 8.5% return from a 'buy and leaseback' approach. Although the REIT manager had indicated its intention to list on the Bahrain Bourse, as of now it remains a private REIT.

United Arab Emirates

UAE joined the Islamic REIT business much later in November 2010 when Dubai Islamic Bank partnered with Eiffel Management, a pioneer of REITs in France to establish the Emirates REIT incorporated in the Dubai International Financial Centre (DIFC). The initial portfolio of the Emirates REIT were management of 7 owner occupied properties secured on about 15 year leases, and worth approximately USD46 mln. Currently, the market capitalisation of Emirates REIT is estimated to be approximately USD200mln, generating average returns between 6% to 8% for the investors. Emirates REIT plans to be listed on Nasdaq Dubai (DIFC) by Q1 2014.

GCC Islamic REITs Industry

Name	Domicile	Manager	Year*	Size (USD mil)	Status
Al Mahrab Tower REIT	Kuwait	Munshaat RE Co	2007	100	Not Listed
Inovest REIT	Bahrain	Inovest	2009	80	Not Listed
Emirates REIT	DIFC	Dubai Islamic Bank	2010	200	Not Listed

*Year of Inception of the Islamic REIT
Source: Anfaal Capital, KFH Research Limited

Singapore

Singapore launched an Islamic trust called Sabana REIT on 26th November 2010 listed on the Singapore Exchange Securities Trading Limited. The REIT aims to invest in income producing industrial real estate used for industrial purposes in Asia. As at 3Q13, the REIT has a portfolio of SGD1.22bln making it the largest Islamic REIT in the world, consisting of 22 properties distributed across four main industrial property segments – high-tech industrial, chemical warehouse and logistics, warehouse and logistics, and general-industrial. During 3Q13, the REIT's gross revenue increased 6.3% year-on-year to SGD21.6mln.

Prospects and Opportunities for Islamic REITs

Islamic REITs have tremendous potential to be developed as a thriving global wealth management product since it is structured on tangible real assets which provide stability as the investments are channelled to the real economy. Real asset and tangible assets investments are also the preferred asset class among Muslim investors and institutions given its natural fit with the Islamic finance principles which advocate link between the real economy and the financial sector. The success of Islamic REITs in Malaysia and Singapore give weight to the assertion that Islamic REITs have strong prospects to be launched in global markets as a lucrative alternative real estate investment product.

Islamic REITs also come with the added advantage of tax savings in most countries including Malaysia where the REIT is exempted from tax payments provided it distributes most of its income (90% in Malaysia) to investors. Islamic REITs provide institutional investors such as pension and provident funds another investment avenue to diversifty their investments. Other institutional investors such as takaful / insurance companies that look for investment to meet their long term liabilities are also likely to be attracted towards Islamic REITs investments. Moreover, takaful operators that mostly have smaller capacity may invest in real estate without signifcant amount of investment capital.

Selected Global REITs Industry Snapshot (as at end-Nov 2013)

Domicile	No. of listed REITs	Market Cap (LCY BLN)
Asia-Pacific		
China	2	22.84
Hong Kong	7	135.55
Japan	43	7180
Malaysia	17	33.75
New Zealand	3	2.08
Singapore	29	66.13
South Korea	8	199.4
Taiwan	6	80.57
Europe*	172	118.61
USA	240	676.21

*Europe market capitalisation is in Euros
Source: Bloomberg, KFH Research Limited

REITs have become popular avenues for investors in global markets to participate in the real estate and infrastructure development of countries. In USA alone, there are an estimated 240 listed REITs bearing market capitalisation of USD676.21bln as at end-Nov 2013. In Europe, the number of listed REITs are 172 with a market capitalisation of EUR118.61bln. In Asia, Japan, Singapore and Malaysia feature among the prominent countries utilising the asset class of REITs.

Conclusion

The development of Islamic REITs, while lucrative, is not without challenges. One of the major challenges in the global development of Islamic REITs in various countries is the lack of clear-cut regulatory framework and standards which can govern the principles and operations of Islamic REITs. Most countries do not have established REIT rules for the listing of Shariah compliant properties while there also exist differences in Shariah interpretations among the various jurisdictions. The growth of Islamic REITs in some regions, such as the GCC, was also hampered by the global financial crisis which had a negative impact on the real estate sector, putting the plans of many managers to launch Islamic REITs on hold.

As Islamic REITs have a natural alignment with the Shariah principles which emphasize real-sector investments, there is a considerable opportunity for financial institutions to introduce Islamic REIT products in the market. To this end, Malaysia has the advantage of being the only country having a comprehensive and clear regulatory framework which provides clarity to managers intrested in operating Islamic REITs. Malaysia's flexibility in terms of allowing 70% foreign shareholding in Islamic REITs as well as placing no restrictions on locally-domiciled Islamic REITs to own foreign assets, provides vast opportunities for foreign REITs managers to make Malaysia as a viable avenue for listing REITs.