

# ISLAMIC REAL ESTATE INVESTMENT TRUSTS (I-REITS): FRAMEWORK AND ITS APPLICATIONS IN MALAYSIA

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**ABSTRACT**--Confusion still exists, particularly among our society in Malaysia on Islamic Real Estate Investment Trust (iREITS), especially in terms of definition as one of investment instrument in the Islamic capital markets, its transaction and its application process, as well as its relationship with conventional unit trust. This confusion is caused by having no exposure to the concept of (iREITS), in addition to the dominance of the theory and concept of conventional unit trust and its influence in the practice of real estate investment unit trust particularly in Malaysia, or the world at large. As a result, this type of investment unit trust is less known among investors and the Muslim community itself. Even in investment transactions, they usually prefer other products of property unit trust from a conventional unit trust system, while Islamic Real Estate Investment Trust itself was introduced in the Islamic financial markets. Thus, this article aims to dispel some of the confusion and ignorance of it and try to show the essence of Islamic unit trust property, its transaction and applications processing, the distribution, the approach and the multiple dimensions of Islam in highlighting it as an investment instrument in Islamic Muamalat system. Consequently, this is to show the contribution of this investment product (iREITS) as an alternative to Islamic investors to expand their financial and property in the Islamic capital market in Malaysia and the world.

**Keywords**--iREIT, REIT, Amanah Saham Hartanah Islam, Islamic Unit Trust

## I. INTRODUCTION

*Islamic Real Estate Investment Trust (iREITS)* is one of the real estate investment instruments that exists in the Islamic financial system. However, it has yet to be recognized by hardcore investors whether Muslim or non-Muslim in the field of financial investments in the national and global context. But its existence in the Islamic capital market up to now reveals a very positive impact on the Islamic capital market industries, furthermore, it could even be an active competitor to the conventional capital market and thus act as a good alternative to investors. Because iREITS is one of Islamic real estate investment products that must go through the transaction process

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based on sharia requirement, then the transaction processes, the contract between the parties concerned and the activities conducted by the board of trustees of this property should be known by the parties concerned in order to avoid a misgivings in thinking about its sharia compliance expounded upon.

## **II. LITERATURE REVIEW: THE DEVELOPMENT OF i-REIT**

Malaysia is among the Asia countries that leads to producing and marketing products based on real estate investment trust (Newell, Ting, Acheampong 2002). It gets an approval from the Central Bank of Malaysia to be marketed in the stock market in 1986 (Hamzah, Rozali 2010). The development of this type of unit trust investment is highly promising, forcing the Central Bank and the responsible body for regulating (Security Commission) the processes and market transaction creates some specific rules and guidelines regarding it in 1995. In 1996 the REITS was first listed on the main board of the Kuala Lumpur Stock Exchange, known at that time with the Trust Property "or" Property Trust Fund "(الممتلكات الائتمانية صناديق)" which later became well known as Real Estate Investment Trusts in Malaysia (REIT) / Real Estate Investment Trust. With the role and encouragement of the National Bank and Securities Commission of Malaysia, several investment trust products that are based on Islamic properties or later on well known as Islamic Real Estate Investment Trust (REIT) in 2006 were established, which were introduced by the Company al-Aqar KPJ REIT. After that this type of product has been growing from time to time until ten companies were published and marketed, but only 3 of them are marketed on Major Malaysian Stock Exchange until 31 December 2014. (Ahmad Tajjudin, Nurul Afiah, Muhammad Najib and Hishamuddin 2015). These are al-A'qar REIT, al-Hadhorah Boustead REIT, and Axis REIT. Al-A'qar Company REIT is the first company in Malaysia and in the world which was a successful company in issuing of iREITS and has made its debut on the Malaysian stock market on August 10, 2006, followed by al-Hadhorah Boustead REIT which was listed on 8 February 2007 and subsequently listed company Axis REIT in December 2008 despite its existence in the Malaysian stock market since August 3, 2005, but the time has not yet fully declared as an Islamic Real Estate Investment Trust (iREITS) (Che Mohamad Adenan 2017)

## **III. DEFINITION OF iREIT**

Generally, REIT is a product that did not exist during the time of the classical Islamic jurisprudence. Thus, its definition was unavailable in Muslim classical scholars' books. However, some of their articles can still be used as guidelines to discuss this topic. According to the definition issued by the Securities Commission of Malaysia, REIT means "Instrument of collective investment based sharia compliance, usually in the form of trust funds, which aims to invest 50% of its total assets in the real estate sector either through direct ownership or special purpose company whose assets are primarily related to real estate" (ISRA 2012). Or "An investment instruments that aim to invest at least 50% of its total assets in real estate whether via direct ownership or through a single purpose company whose assets comprise real estate principle". Moreover, according to (Zairulnizad Shahrin 2010) REIT is a "collective investment scheme whose assets are invested in the real estate sector (usually in real estate commercial buildings) for which the tenant activities are permitted by Islamic law. Or "a collective investment scheme in real estate in which the tenant operates a permissible activity according to sharia law".

In accordance with the definition above, we can define REIT as a "trust fund investment in the form of collective purpose with the aim to raise funds from investors and will be used or invested in real estate sector in which its activity is in accordance with the principles of sharia used for buying property, managing or selling the property assets (Che Mohamad Adenan 2018). In other words, it is a "collection of money or capital to a fund managed by professional managers who have a distinctive investment strategy in the real estate sector intending to give advantages to those who invest in the fund.

Among the investment activities of investors also are buying such property and develop it with commercial buildings, housing or factories and then rented it to a tenant. Then the trust fund will profit through a rental revenue, while the property remains under the ownership of the trust fund or under the property of "other real estate assets" like units of open shares for any real estate companies that issued the stock of properties listed on the Stock Exchange (Share in public listed property companies) or closed bonds for real estate companies (Unlisted debt securities of property companies). Investment trusts funds were going to make a profit through the rental of the property traded, and it will be distributed to investors according to their proportion investment in the trust fund in the form of cash benefits.

Besides, investors will also benefit from the proceeds of the sale and purchase of shares by the fund traded on the open Stock Exchange Market. Distribution of profit dividends is also in the ratio of their investments in Islamic real estate investment trusts for its holding period. In other words, the basic objective of this Fund (iREITS) is to provide a profit and returns to investors or unit holders in the form of scale benefit the revenue generated by the property owned as well as an increase in the value of the property (Security Commission, 2006). While the iREITS structure is practically a combination of the best features of the property to the unit of trust funds and it was among the bonds and securities (Security Commission, 2007).

#### **IV. THE TYPES OF iREITS**

The iREITS industry in Malaysia has begun from good development on conventional REIT itself which is applied in Malaysia. After that, it began efforts from several parties to introduce Islamic REITs to investors by adjusting management system, activities, transactions, and its contracts in accordance with the substrate and the mold of Islamic real estate investment trust system. Therefore, the types and categorization of iREITS also have not much difference in terms of theory with the types of conventional REITs. Thus, the iREIT type can be divided into 3 types: Equity iREIT, Mortgage iREIT and Hybrid iREIT:

##### ***Equity REIT:***

Equity REIT Fund is an investment trust fund owning real estate operations for generating returns involving a different kind of sharia-compliant activities such as real estate leasing, commercial development as well as rental services. Usually, this type of equity trust fund will buy more properties for investment portfolio and is not just for development and resale. Therefore, it has a variety of properties such as buildings, houses, offices, farms that will generate income.

This type of REITs is used in Malaysia in order to conduct real estate investments because it has excellent potential for a long-term investment with stable dividend yields and strong capital gains when trading in the stock

market Exchanges. Therefore, investors or unit holders of equity REITs are investing in the real estate portfolio that will bring returns (Zairulnizad Shahrin 2010) and stable revenue from its operations in investment activities.

From all the types of REITs, the only iREIT applied in Malaysia is equity iREIT, because it is the only type that can be adapted the regulations and guidelines of sharia-compliant which has been issued by the Securities Commission of Malaysia, as well as this type of iREITs only so far are free from non-sharia elements, which are elements of gambling, gharar (uncertainty) and riba (Ashraf Wajdi 2008).

## **V. CATEGORIZATION OF iREITS**

iREITS can be divided into two categories, listed iREITS and unlisted REIT (Ernst & Young, 2007). For iREITS listed on the Stock Exchange, it can be purchased through a stockbroker, as other stocks traded. iREITS can also be traded at a premium and discount on net asset value. While for iREIT that is not listed, then it is like other unit trusts which can be sold and purchased from the management company of iREIT assigned or appointed agents and authoritative parties.

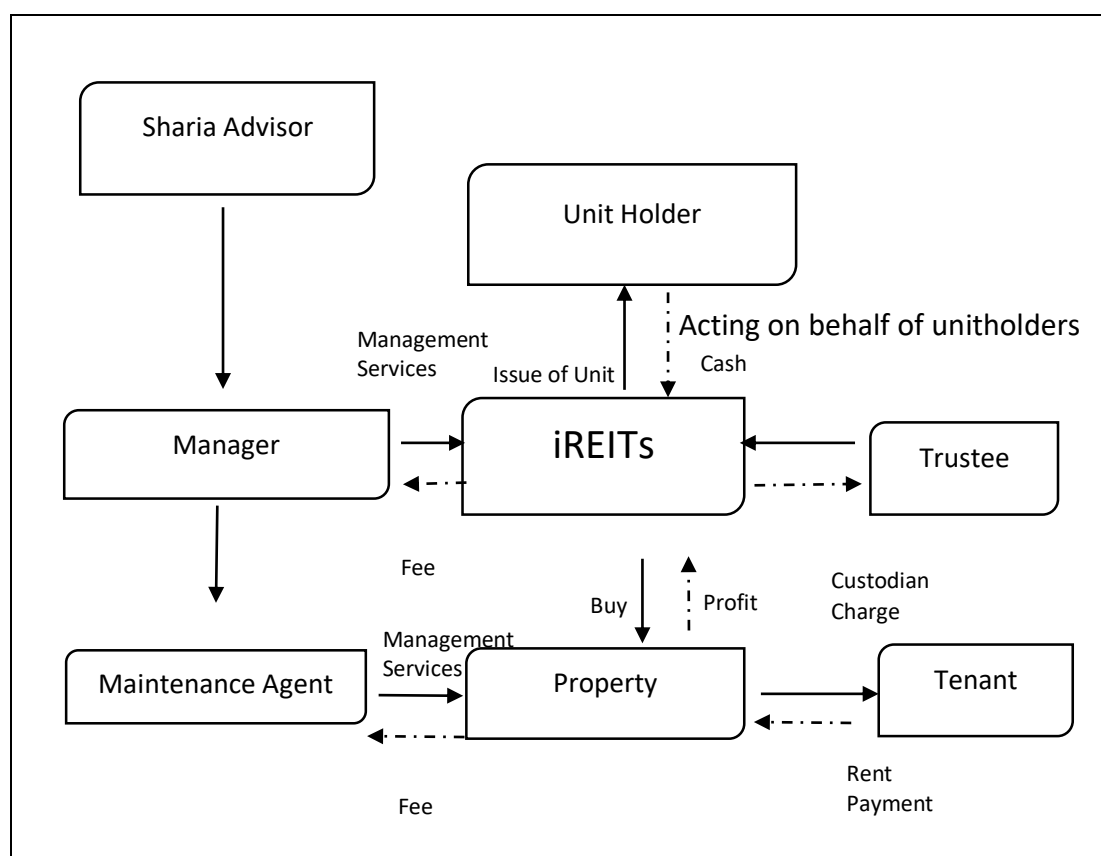
The differences between iREITS listed and unlisted iREITS are; first: the ownership of the abroad real estate. The only listed REITs can own an abroad property as well as subject to the approval of the Securities Commission of Malaysia and the authorities of other (Ernst & Young, 2007). Second: in the point of investment, both may invest in real estate-related assets and real estate assets that are not related but different from in percentage. For REITs listed in Malaysia Stock Market 75% of its assets must be invested in real estate and 25% can be invested in real estate related assets and not related to real estate assets.

But for the iREITS that are not listed on the Stock Market Exchange of Malaysia 70% must be invested in real estate-related assets, while 20% must be invested in liquid assets and 10% can be invested in assets related to real estate and non-real estate related.

## **VI. THE iREITS APPLICATION IN MALAYSIA**

As described in the previous section, there is only one type of iREIT that has been used in Malaysia, namely the REIT equity. This is because only this type is the most appropriate to implement elements of the sharia-compliant compared to other types. Among a few publishing companies that adopt this type of REIT upon approval from the Securities Commission of Malaysia are Al-Aqar KPJ REIT company, al-Hadhorah Boustead REIT company, Axis REIT company, and KLCC REIT company.

For better understanding regarding the operation of the REIT practiced by some companies mentioned earlier, we need to understand the operational structure of the application at the first stage until the last stage, so we will know the forms of Sharia-compliant contract among the various parties involved in this process. The structure is as follows:



**Figure 6.1:** The basic structure of i-REITs  
(Source: Securities Commission Malaysia)

Figure 6.1 shows iREITS structure involving several related parties, such as iREITS Management Company, unit holders or investors, the trustee (trustee), the lessee (tenant), maintenance agents and sharia advisers appointed. The shape of this structure is the same in all companies that apply the iREIT in Malaysia, as well as the structure of a conventional REIT company. But the distinguishing factor between the iREITS and the REIT is at the level of sharia Advisory board or sharia committee. A conventional REITS company has no sharia advisers. Whereas in iREITS structure, the Shari'a advisers have a big role to ensure the company's operations are in line with the Sharia requirement.

The role and responsibilities of the Sharia adviser has been thoroughly outlined by the Securities Commission of Malaysia on December 5, 2005, in the implementation of the guidelines and rules of the REIT. These rules and guidelines are created on lawsuits related securities of REITs Guidelines 1993 and 2012 before the implementation of a REIT was approved by the Securities Commission of Malaysia. Shariah Committee is an important part of the iREIT itself. It acts as an advisor to all problems related to the implementation of sharia in i-REITs. This Committee is also responsible for advising the iREITS company before the implementation was carried out. It must always regulate all actions to be taken and monitor the work of the fund from the point of sharia view and review all transactions on every level to ensure that such activities are not contrary to sharia, thus can ensure that the entire operation of the iREITS is in line with the Shariah Compliant.

In addition, the Shariah advisors are also responsible for ensuring the operation of iREITs in accordance with the guidelines of the implementation of the investment, provide referrals and consultation with the manager in the investments authorized as specified in the guidelines of the implementation of the iREITs, and shall prepare reports and propose it for inclusion in the interim and annual reports of a company i-REITs.

While in the management level, it must appoint a specialization company in the field of real estate investments to administer the iREIT in accordance with the objectives and goals of the i-REITs. This appointed management company will try to raise funds from investors. After successful capital funds are raised from investors, it will be invested in real estate assets or the assets related to real estate. This action is made to ensure that the investments stretchers is on the right track and can maximize the benefits of the iREIT. Besides, this i-REIT management company appointed can also invest in assets that are not related to real estate in a predetermined amount (as was mentioned in the implementation of the guidelines REIT).

For the existing assets which have become the possession of the iREIT, the company's management may appoint another body to be known as the property manager to manage any significant assets related to real estate owned by i-REITS. This management company will also receive a fee to be taken from the fund of iREIT based on a percentage which was agreed by related parties, according to their service of management is carried out, their expertise and skills available on iREIT Management Company, securities laws, i-REIT and REIT guidelines. Besides, it acts to streamline existing requirements and the relationship between several parties involved in the operations of iREITS investment. There is a need for understanding the guidelines of the implementation of iREITs especially between iREIT managers and investors or trustees, as well as the relationship between the iREIT and the trustee (trustee). While on the trustee position, it is the part who plays a role to protect the interests of unit holders or investors not to apply any uncertainty and deception of the management company in order to avoid any loss of the profit to them. The trustee is also responsible for overseeing the management company to always follow the guidelines laid down by the authorities.

In addition, it also acts as representative to unit holders and as a custodian for iREIT funds invested by the management company, as it should also ensure that rental rates for tenant to be reasonable under current rates (Shabnam Mokhtar 2009). In the end, the trustee will receive management fees from iREITs management on the services provided.

At the level of investors or unit holders in iREIT, they will get the benefits in the form of dividends distributed by iREITs management. The dividends will be distributed according to the percentage of the value of units held, and also through the capital gains from property sales and rental revenue of iREIT assets. The relationship between the stages in the basic structure of i-REITs has a certain contract or agreement and has been debated from both the sharia non-Sharia point of view by the sharia advisory board on all levels, whether at the level of the National Bank of Malaysia, Securities Commission of Malaysia, the iREIT committee sharia as well as academicians or researchers of Islamic finance. For future review of the issue, a debate of Islamic Jurisprudence Scholars related to this subject will be presented in detail. Above all, and most importantly, what was approved at the Securities Commission of Malaysia and the Sharia Advisory Board level at the National Bank of Malaysia has been considered as Sharia-compliant and can be implemented and practiced in Malaysia.

## VII. CONCLUSION

I-REITs industry in Malaysia is one of the new alternatives to investors particularly Muslim investors to develop their assets and property. Positive achievements by the companies issued with iREITs in the Market such as Al-Aqar KPJ REIT, Axis REIT and KLCC REIT proves that it has the potential to maximize sustainable profitability and return on investment according to the Islamic system and at the same time it can empower the Islamic economic system in stiff competition with conventional systems. Even though the real estate sector is considered as tough because of its nature unliquidity growth, but through the operation and application of i-REITs then the problem could be solved because it facilitates the liquidity of the real estate sector through fractions of units traded on the Stock Market Exchange of Malaysia.

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