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The Chronology of REITs Development in Malaysia

Suhana Mohamed (Corresponding author)
Faculty of Business Management, Universiti Teknologi MARA
Jln Heman, Kg. Aman, Larkin, 80350 Johor Bahru, Johor
Tel: +060197459 392 E-mail: suhan291@johor.uitm.edu.my

Associate Prof. Dr. Haliza Hirza Jaffar
Academy of Language Studies, Universiti Teknologi MARA
Jln Heman, Kg. Aman, Larkin, 80350 Johor Bahru, Johor
Tel: +06072336500 E-mail: halizah@johor.uitm.edu.my

Rohana Sham, Abdul Razak Jambari, Zuliana Zoolkefli and Nor Fazlin Uteh
Faculty of Business Management, Universiti Teknologi MARA
Jln Heman, Kg. Aman, Larkin, 80350 Johor Bahru, Johor

ABSTRACT

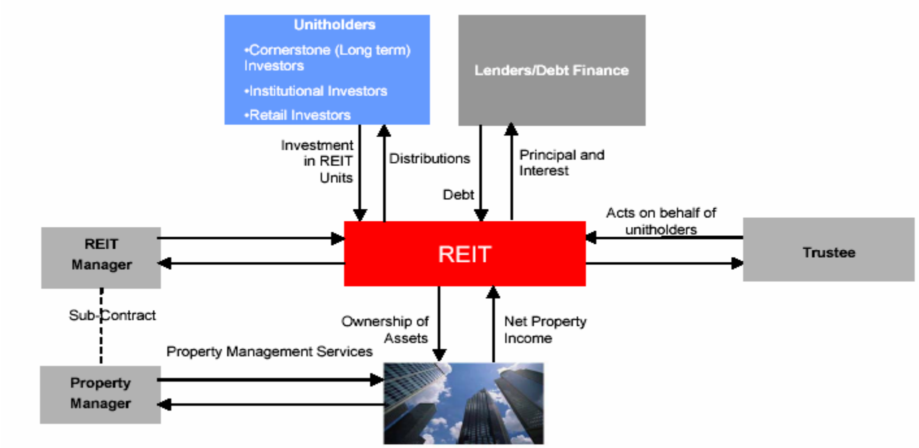
This research paper investigates the development of Real Estate Investment Trusts (REITs) in Malaysia from 1986 until now. REITs are investment vehicles which enable the flow of funds from investors to the real estate sector of the economy. Their major income comes from rents and most of the profits must be distributed as dividends to their shareholders. The purpose of this research is to document the expansion of REITs market in Malaysia and to provide information to potential investors, especially retail investors, on the current market scenario. As of December 2011, Malaysia has a total of 14 REITs; 11 conventional REITs and 3 Islamic REITs. This is a conceptual paper that will only discuss the development of the Malaysian REITs market over time. The findings revealed that the Malaysian REITs market needs to be more developed. The outcome of this research hopefully will be invaluable to REITs investors and direction on the future direction of the Malaysian REITs market.

Keywords: REITs, Islamic REITs, REITs developments, Type of REITs.

1. Introduction

Real Estate Investment Trusts (REITs) are investment vehicles that enable the flow of funds from investors to the real estate sector of the economy. REITs investors aim to enjoy real estate returns and portfolio objectives while retaining the investment liquidity provided by the secondary market for REIT shares (Corgel, McIntosh, & Ott, 1995).

Figure 1 shows the REITs structure that has been adopted by Malaysia. There are two unique features that REITS have, firstly, its primary business is managing groups of income-producing properties and, secondly, it must distribute most of its profits as dividends. A REIT is traded in stock exchanges and gives investors returns through capital appreciation from price increases and dividends like any listed company's shares.



Source: Vinod, K. (2009)

Figure 1: REITs Structure

The equity investments depend on capital gains as the main source of return for investors. The relationship is; when there is a positive movement on share prices, investors will gain and they will lose if the share prices move otherwise. REITs offer lower capital gains due to its lower stock price increases, but have stable and sizeable dividend payouts annually. Investments in both REITs and real estate market definitely have a similarity whereby both investments offer ownership of the properties being invested through the stock market or the physical property market. However, the difference is that REITs are more liquid than real estate because with REITs whereas buying and selling of real estates such as landed properties and shop lots will normally take a longer time.

REITs market is expected to become an attractive investment with forthcoming positive macro economy numbers and higher disposable incomes. Malaysia is the first country in Asia to introduce property trusts. The first trust was listed on the Kuala Lumpur Stock Exchange (KLSE) in 1989. There were only four property trusts listed on the KLSE during its earlier presence in the market. The trusts were Arab-Malaysian First Property Trust (August 1989), First Malaysia Property Trust (November 1989), Amanah Harta Tanah PNB (December 1990) and Mayban Property Trust Fund One (March 1997). However, these property trusts were not popular among institutional investors (Newell, Ting & Acheampong, 2002).

2. Empirical Evidence from Previous Research

The regulatory framework for listed property trusts in Malaysia was approved by the Central Bank of Malaysia in 1986. Specific Securities Commission guidelines for property trust funds were developed in 1991 and revised in 1995. Since then, many developments had taken place in the REITs market.

Ting, Wong and Newell (1998) investigated and found that some regulatory and operational differences exist for listed property trusts in Malaysia when compared to the United States and Australia. Then Ting (1999) found that property trusts in Malaysia able to contribute significantly on stocks and short-term investments in the total portfolios unlike in the United States and Australia, with the level of non-real estate in the portfolio being as high as 40 per cent in previous years. The significant growth in Bursa Malaysia over the period of 1991–1997 was not reflected in corresponding performance and growth in the listed property trust sector, although the Malaysian national economy and developing real estate market were on the uptrend movement for the same period.

Ting (1999) and Shun (2003) found out that the factors that slowed down the development of listed property trusts in Malaysia were (i) poor perception and lack of demand for the product amongst investors, (ii) properties available for acquisition were providing low yields, (iii) too few institutional investors in Malaysia, (iv) strong performances by competing investment options, and (v) local investment awareness favored speculative investments.

In Malaysia, the level of institutional investment is very low in the REITs market. Newell, Ting & Acheampong, (2002) found that the overall response of institutional investors in Malaysia towards REITs is low-keyed and institutional investment only held 4 percent on the average in Malaysian REITs (Ting, 1999) compared with 29 percent in American REITs (Chan, Erikson & Wang, 2003).

3. REITs Development in Malaysia

Malaysia issued the world's first Islamic REIT (which includes the principles of Shariah – the body of Islamic law) in 2006. This development is significant, as it is another form of ethical investment and will increase liquidity and transparency to the international REIT market; particularly via increased acceptance from Islamic investors globally. At the end of 2008, there were only three Islamic REITs in the world, with all three in Malaysia; namely Al-'Aqar KPJ REIT (hospital properties), Al-Hadharah Boustead REIT (plantation properties) and Axis REIT (office/industrial properties). Axis REIT has reclassified itself into an Islamic REIT in December 2008. By end of December 2008, the total market capitalization of these three Islamic REITs was US$354.7 million (RM1228.9 million), representing 30% of Malaysian REIT market capitalization (RREEF, 2009).

The development of the REIT market is discussed in two wide areas which are firstly, the regulatory framework, and secondly, its industry growth.

3.1 The Regulatory Framework

Malaysia is the first country in Asia to introduce legislation to permit the formation of listed property trusts. In 1986, Bank Negara Malaysia (the Central Bank of Malaysia) approved the regulatory framework for listed property trusts where the principal governing their establishment and operation was the Companies Act 1965 and the Securities Industry Act 1983. Specific guidelines on property trust funds were introduced by the Securities Commission in 1991 and later revised in 1995.

In 1999, the Securities Commission embarked upon a consultation process in relation to property trust funds vis-à-vis the likes of similar products in other jurisdictions, such as REITs in the United States and property funds in Singapore. It issued a Consultation Paper on Property Trust Fund and *Consultation Paper on Property Trust Funds and Real Estate Investment Trusts in 1999 and 2002 respectively.*

Pursuant to the Finance Act 2004, which was gazetted in December 2004, REITs will enjoy tax treatments as follows:
(a) REIT to be exempted from tax on income distributed to its unit holders whereas the undistributed income will be taxed at 28%;
(b) Income distributed to unit holders will be taxed at their respective taxes. However, for non-residents, tax payable at 28% will be withheld by REIT; and
(c) The accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hand of unit holders.

Under the Finance Act 2004, REITs investors enjoy stamp duty exemptions on all instruments of transfer of real property. Property owners who sell their properties to REITs are also exempted from real property gains tax. However, the filing obligations imposed under the Stamp Act 1949 and the Real Property Gains Tax 1976, are still required to be adhered to.

On January 3, 2005, the Securities Commission issued the new Guidelines on Real Estate Investment Trusts to govern the operation and administration of REITs in Malaysia. The amended guidelines have generated a lot of excitement and discussions among industry players, with a number of them, especially those with sizeable investment properties, seriously considering injecting their assets into such trusts. The key features of the new guidelines, which are major improvements from the old guidelines, include the following:
(a) Liberalization of the borrowing limit for a REIT;
(b) Relaxation of rules on acquisitions of leasehold properties;
(c) Flexibility in the acquisition of real estate that is encumbered by

financial charges;
(d) Eligibility requirements for management companies that manage REITs have been streamlined;
(e) Introduction of a declaratory approach in the establishment of REITs; and
(f) Enhancement in the amount of exposure and reporting required which is consistent with international standards.

On November 22, 2005, the Securities Commission issued the *Guidelines on Islamic Real Estate Investment Trusts* (Islamic REITs) to facilitate a further development of new Islamic capital market products. Malaysia is the first country in the global Islamic financial sector to issue such guidelines and has set a global benchmark for the development of Islamic REITs. The Islamic REITs guidelines complements the existing guidelines on conventional REITs. *Syariah* (Islamic jurisprudence) compliance criteria are provided in the guidelines to guide management companies in their activities relating to REITs, including the types of *Syariah* permissible and non-permissible rental and investment activities.

3.2 Industry Growth

The first Malaysian listed property trust, Arab Malaysian First Property Trust, was launched in September 1989. The second listed property trust was First Malaysian Property Trust, established in November 1989, and followed by the third listed property trust, Amanah Harta Tanah PNB, which commenced in December 1990.

The fourth property trust was the unlisted Mayban Property Trust Fund One launched in 1990. Mayban Property Trust Fund One was listed on the KLSE in June 1997 and was known as Amanah Harta Tanah PNB 2. The First Malaysian Property Trust, however, ceased its listing in July 2002. As of the end of April 2005, only three property trusts remain listed on the Bursa Malaysia comprising AmFirst Property Trust (formerly Arab Malaysian First Property Trust), Amanah Harta Tanah PNB and Amanah Harta Tanah PNB 2.

Following the introduction of the new Guidelines on Real Estate Investment Trusts in January 2005, Axis Real Estate Investment Trust was the first to be listed on Bursa Malaysia on July 29, 2005. Next, Starhill Real Estate

Investment Trust, the country's largest REITs was listed on December 16, 2005, followed by UOA Real Estate Investment Trust on December 30, 2005. Currently, a total of 15 REITs which comprise of 12 conventional REITs and 3 Islamic REITs are available for investors to choose from in Malaysia.

3.3 REITs Operations

Most of REITs funds in Malaysia are closed-end funds unlike the traditional unit trust which are open-ended. REITs are typically listed and their market values may or may not be their net asset values (NAVs). Owing to nature of their assets, the computation of NAVs by REITs is different from that of securities mutual funds. REITs are income-oriented and investors expecting a regular income are motivated to invest in REITs. Statutorily, REITs must distribute a substantial part of their taxable profits (Vinod, 2009).

The difference between conventional and Islamic REITs is in the REITs structure, whereby Islamic REIT investments, operations and management must be monitored, reviewed and approved by the appointed Shariah Adviser. The areas of concern are:

[1] Rental of Real Estate
[2] Investment Deposit & Financing
[3] Insurance/Takaful
[4] Risk Management

(Aznan, 2011)

4. Conclusion

This study has investigated the development REITs in Malaysia. Hopefully the findings can help both institutional and retail investors to comprehend the risk-return trade-off and to consider REITs as another viable investment alternative. The current Malaysian REITs market has shown an increasing demand from both local as well as foreign investors, especially in the past 3 years. The huge potential in the domestic property sector through the initiation of the Government's Economic Transformation Plan (ETP) which targets the domestic property sector to increase in the medium to long-term range, provides the stimulus for this research to be conducted. Studies conducted on Malaysian REITs until 2005 they had focus on the performance of the initial four REITs, and emphasised on the attribution of the infamous Asian financial crisis in 1997 (Newell, Ting & Acheampong, 2002; Sing, Ho & Mak 2002; Ooi, et al. Ooi, Newell & Sing, 2006; Ting & Yunus, 2007 and Hamzah, Rozali & Tahir, 2010).

Given the promising development of Malaysian REITs, it is essential for Malaysian REIT yields to be attractive compared to other investments, as most domestic investors currently assess Malaysian REIT yields with current investment alternatives such as equities and bonds. It is also essential that Malaysian REIT yields in the initial 3-5 years are attractive to attract domestic investors, who are relatively unfamiliar with the REIT product; however a high yielding REIT may carry an additional risk premium.

An appropriate tax treatment is essential as Malaysian REITs are compared to domestic investment alternatives; thus tax transparency is relevant. It is also very important that the Malaysian REITs provide a portfolio diversification to the stock market, following worldwide trends. Malaysian REITs should provide a variation to the market, i.e. a low beta, to enable Malaysian REITs to act as an alternative asset class compared to stocks and bonds. To a certain point, the availability of quality properties seems to be a subjective issue, as quality properties may be construed as high-end properties. REITs manage and optimise a portfolio of properties; thus yield, yield growth and risk management are important assessment factors, as REITs can invest and manage high-quality or low-end properties (e.g. lower income hypermarkets, etc). Strategic property location is generally crucial as a key fundamental to ensure that a property maintains a high-yielding performance or income stability.

Normally, people invest in REITs for so many reasons. Among the reasons are diversification, asset allocation objectives with real estate as a priority, dividends, liquidity, performance, liquidity with real property backing.

A secure and favourable tax transparency treatment locally and internationally is essential, as REITs worldwide are known to be tax transparent. Reductions in the withholding tax rate on distributions to local and foreign investors are important. In the Malaysian REIT sector, the withholding tax is 10 percent for individual investors from 2009 and this is constantly compared with Singapore which has zero percent tax for its resident investors. Thus one key to attracting foreign investors will be to maintain a competitive tax regime comparable if not better than the local regional REIT markets.

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