The Principles of Malaysia Islamic Real Estate Investment Trust: Contemporary Islamic Core Values

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Abstract

The Islamic capital market operates in parallel with convention capital market in expanding, deepening, and broadening Malaysia financial system. The Islamic Real Estate Investment Trust (Islamic REIT) serves as an alternative Islamic investment instrument to sukuk and shariah compliant stock, which observes Islamic REIT experiencing a significant growth and demand in portfolio property value and Islamic market capitalization. The attractiveness of Islamic REIT has made it to become one of the common real estate investments apart from the physical property investment with a long-term and cheaper capital for property ownership. Likewise, the continual expansion of the Islamic REIT market in Malaysia is making great financial motivation that expands the investment spectrum. Therefore, the need to review the Malaysia Islamic REIT framework to thrive and revitalize structures conforms to the shariah laws and the guideline issued by security commission of Malaysia. This inevitably means the behaviours and operation of sub-Islamic components operating under Islamic financial system need to observe within the rules and principles of shariah laws. Through model of business, investors can invest in an Islamic REIT in the without having to buy, manage, or finance property and income that produced through its various real estate investments.

Keywords: Islamic REITs; Shariah principles; Islamic principles

JEL Classification: K10; G380; Z120

1. Introduction

Enhance and innovative development is needed for the various investment products and opportunities to identify the benefits of enhanced property portfolio diversification and compliance to regulation necessary for holding of the Islamic securities. Furthermore, with the awareness of global property investors increasing, the need to develop more innovative performance analyses, particularly for the Islamic market players (O'Neal, 2009). Moreover, Islamic REIT therefore served as the alternative Islamic investment instrument to sukuk and shariah compliant stock, the growth and the demand of Islamic REIT has been experiencing a significant growth and demand in portfolio property value and market capitalization.

Malaysia introduced the Islamic REIT as a diversification of investment products and shariah compliant and therefore considered to be an ethical form of investment that compliance with shariah principles and applies in all Islamic transactions. Islamic law forbids Islamic institutions from engaging with haram when offering products and services. The introduction of guideline for Islamic REIT in November 2005 issued by security commission of Malaysian property regulations, the REIT environment in Malaysia has greatly improved, some of the key revisions include setting up a transparent tax structure that and REITs exemption from gains tax and stamp duty associated real estate property which boomed and attracted more investor to invest into Islamic REIT market. Nevertheless, Islamic REITs paved way for the first establishment of the first most sophisticated Islamic REIT in the world in term of its structured and underlying principles based on the shariah law. The incomes and fund management of Islamic REIT should observe key feature principles of shariah.

According to the security commission of Malaysian, Malaysia REIT guidelines defined Islamic REIT is a collective investment scheme in real estate that that its tenants operate permissible activities for investment purpose but must be compliant to the shariah. A new milestone in Malaysian REIT market was the world first developer of Islamic REIT in 2006, a REIT structured based on shariah and all its transactions were compliant to shariah laws and principles. The major boost of this market was the provided guidelines released by the security commission of Malaysian that majorly impacted its REIT operations and acted the vital role of promoting the growth and development of Islamic REITs in the international Islamic finance as well as financial community in Malaysia. The established four Islamic REITs in Malaysia becoming an alternative investment vehicle with the shariah-compliant stock and sukuk, the growth of Islamic REIT was impressed by other global Muslim real estate investors and making it known as the major Islamic investment vehicle (Ibrahim et al., 2009)

2. Background Islamic Real Estate Investment Trust in Malaysia

The Malaysian REIT marks new milestones when shariah advisor council of security commission of Malaysian released guidelines pertaining to the Islamic REIT dated November 2005. Nonetheless, its paved way for an establishment of first Islamic REIT based on Islamic principle, the Al Aqar Healthcare REIT, launched in June 2006. It included the principles of shariah in the REIT structure, which is the underlying Islamic principles uphold the concept investment free from israf, riba, gharar and maysir. Since the Islamic players had been accepted globally especially in the shariah compliant stock and sukuk. Introducing Islamic REIT was a significantly enhancing the milestone of international REIT market, the involvement of shariah principles in the REIT development process ensured that ethical investment was made which increase liquidity and transparency of the RIET market, by the end of 2019, Malaysia had developed four Islamic REIT namely; (1) Axis REIT that involved in office and industrial properties; (2) Al-Salam REIT mixed up in commercial retail, office and industrial assets; (3) Al-Aqar Healthcare REIT that muddled in hospital properties and (4) KLCC REIT explorer in office and retail properties.

The first Islamic REIT approved and to be listed in Bursa Malaysia by the shariah advisor council of security commission of Malaysian was the Al-Aqar Healthcare REIT in 2006. Al-Aqar Healthcare REIT made an investment of an estimate of 23 hospitals with a property portfolio value estimated at RM1.57 billion as at December 2019 (Al-Aqar Healthcare REIT, 2019). In the subsequent year, another Islamic REIT, the Axis REIT which had been establishing as conventional REIT was then restructured according to the guideline on Islamic

REIT by shariah advisor council of security commission of Malaysian to make it be able to be classified as a shariah-compliant REIT in Malaysia. Axis REIT made an investment in 54 office and industrial properties with portfolio property value of RM3.02 billion at December 2019 (Axis REIT, 2019). In 2013, Malaysia developed and established third and the largest Islamic REIT in the world, the KLCC REIT which manages office, retail and hotel properties with a market capitalization of RM11.04 billion (KLCC REIT, 2019). The most recent listed Islamic REIT on Bursa Malaysia, the Al-Salam REIT well-diversified shariah compliant Islamic REIT listed in with market capitalization of RM333 million, involved in the commercial property based in Johor bahru where the benefit from Iskandar Malaysia programme as well as closed proximity to Singapore with portfolio property value of RM1.19 billion as at December 2019. (Al-Salam REIT, 2019).

The security commission of Malaysian has an advisory council that handles issues related to Islamic finance called the shariah advisor council, in November 2005 published guidelines to be observed by all Islamic REIT in Malaysia. Moreover, every REIT management company has to establish a shariah advisory committee which advises the company to ensure its operational matters comply with shariah principles.

3. Review on Shariah Principles

Prohibition of Excessive Consumption (Israf)

All different kinds of resources such as an asset are regarded as gifts from God given to human being as trusts. The trustees who are people are supposed to use these trusts efficiently to maximize output therefore establishing prosperity in the world. The goal that every Muslim should achieve, and this has an implication that is vital in ownership of wealth. A Muslim should be involved in those economic deeds triggered by those motives that are not personal when obligated to trust. This kind of economic trusteeship principle in an Islamic environment is opposed to the principle of self-interest which is in an actual sense a pillar in a free-market economy.

In the economic circle, where wealth acquisition and earning of wealth is the first stage, consumption which means wealth expanding for human satisfaction like shelter, food and clothing as the serves as the last stage. Human wants are regarded as insatiable such that when consuming wealth, one should be extremely careful. There should be self-control when utilizing natural resources and when consuming wealth according to Islam (Mohamad et al., 2015). Israf is regarded as thirty-second sin as it regarded as wasteful expenditure as mentioned in Quran and traditions. According to Quran and traditions based on finance, a wasteful expenditure is a sin. Therefore, as Islamic traditions said, "… eat and drink and not extravagant; surely, he does not love the extravagant." These expressions are from Surah Al-A'raf 7:31. The quote, it is clear that in any dealing that is based on a transaction targeting people to have a high paid and exploit the other is rendered illegal (Obana, 2015). In any business, there is no need for a businessperson to set higher profits for an economic activity, as compared to gambling and riba issues, israf is a sin and not accepted in Islam land.

Islamic states beliefs that the acquisition and disposal of resources need to be satisfactory among its stakeholders. The allocation and distribution should be according to the Islamic teaching in the Islamic REIT structure, therefore the undivided ownership of properties under the Islamic REIT structure needs not to be consumed or dominated by REIT company but instances the properties belong to the unit holders. In this perspective, it is important that israf be condemned as a way of ensuring the shariah laws are followed as well as fair sharing and investment on Islamic REIT structure.

The Prohibition of Payment and Receipt of Interest (Riba)

Receipts and payments of interests are prohibited by Islamic law something that is the central characteristics of the Islamic finance (Naifar, 2016). Riba is any growth or increment of debt that the borrower is obligated to pay the lender. The Sunna and the Quran strongly prohibit any payments done over the principal amount as interest payment. Riba has been spread into two categories by Muslim scholars. The first category is riba al-Nasi'ah, which is that interest in loans which is fixed before loan awarding and contains a positive return and acts as a reward to a lender for waiting (Abdul-Rahman, 2014). This is prohibited under the shariah law. The second one is riba-al-fadl, which is that payment over the paid debt. riba-al-fadl results from the sale transaction who's underlying Ribawi Items (gold, silver, barley, wheat and salt) sold by weight and measures. Additionally, this is seen in additional payment done to the creditor by the debtor in exchange for goods of the same kind. Shariah is trying to do away with all forms that are intrinsic in the premises of interest and business transactions that are unjust for example gold should not be exchanged for silver but gold (Abdul-Rahman, 2014).

Economically in the world of finance, at any given time it is not guaranteed that one will gain from any business, some losses may arise due to uncertainties and risks involved. Therefore, during the active employment of capital, risks are involved which should be spread and shared by capital provider and entrepreneur, the share profits of productive it should be fair according to Islamic laws. A person seeking a debt is required to share the risks involved when using it or else it supposed to be given back without any additional amounts or return. In Islamic REIT structures conforms to the shariah laws and the guideline issued by security commission of Malaysia, when the properties in Islamic REIT portfolio owning any asset for the purpose of investment, the assets acquired are free from riba activities and mainly held as the part of Islamic REIT portfolio. In Islamic laws, it prohibits an interest element when dealing with underlying business.

The Prohibition of Excessive Uncertainty in Contracts (Gharar)

In literal terms, gharar means deceit, risk, uncertainty or fraud but in the world of Islam means those transactions that contain elements of uncertainty maybe because some knowledge or information about the outcome lacks a contract (Ang, 2013). The information or knowledge may be of the nature or quality of the contract. It is a requirement by the shariah there should be truthful disclosure and transparency in contract information, such conditions and terms laid down helps the investors to prevent risks of purchasing items that lacks a contract. Nevertheless, it will help where one party took unfair advantage over the other party (Elfakhani & Sidani, 2015). Deliberate withholding of information or giving information that is incomplete by one party in unacceptable and it is prohibited. Gharar is that condition that may result in injustice therefore lead to a contract to be termed as void.

The fundamental terms of contracts are time, price, each parties' obligations, and delivery. In any investment, contacts are regarded as unlawful as it is not certain or particular that the products can be presented for sale or earn profits (Visser, 2013). In the Islamic REIT structure, it will be regarded Islamic real estate management, the tenant agreements in the real estate to be conducted are in terms of contracts, for instance, paying amount of rental or compensation for the damages does not infringe any laws pertaining trading in Islamic states.

The Prohibition of Gambling and Chance-Based Games (Maysir)

Money is earned through efforts or working hard rather than by mere chances. In the Quran, Surah Al-Baqarah: 219, it is argued that strong drink and games of chance or known as maysir are great sin and utility for men, the sin in these two are greater than usefulness. Islamic financial institutions are not allowed to engage in financial transactions by use of incentives and immoral enticements given through a game of chance. In a similar way, receiving of benefits or money at the cost of other people, owning that benefits or money by chance is prohibited by shariah law (Obana, 2015). Some financial instruments covered by maysir include embedded option bonds, option contracts, futures contracts and lotteries. These all transactions are based on uncertainties in business, which is not allowed in any financial dealing in the Islamic society.

In the Islamic REIT properties portfolio, the properties must be free from any activities which is prohibited under shariah. Although the business operation under the properties activities in the real estate generates rentals but does not follow the shariah law instead it infringes to comply during the shariah law. Therefore, maysir are considered as unlawful way of gaining returns in the Islamic states (Shariq, 2010). The maysir dealings are prohibited as it may lead to contract of Islamic REIT tenents depend on the future outcome. Moreover, when investing in real estate, there is need for being certain in the present and no possibilities of the outcome in the future. In any Islamic business, it is encouraged that all investments terms and conditions stated and no options that one party can either be infringed and the other earns more profits.

4. Islamic Principles underneath the Malaysia Islamic Real Estate Investment Trusts Structure

Al-Wakalah

According to Abdullah and Chee (2010), the principles of Wakalah is a contract of agency which implies undertaking a piece of work or offering a service on the behalf of another person. Generally, the principles of Wakalah means protection or remediation on behalf of others. On a legal note, Wakalah refers to a type of contract in which an individual gives another party or known as agent the authority to enter into a legal agreement on the behalf. An action that an agent performs as a representative of the principle, who institutes a contractual and commercial on fixed fees. The need of an appointment of an agent in the transactions arises because the principal may not have the knowledge, expertise, or the time to perform the actions. In terms of language, Wakalah has two meanings; 'custody' and 'surrender' while in terms of fuqaha, al-Wakalah to provide others with power or authority to manage certain matters under the authority of the principal (Abdullah & Chee, 2010).

Therefore, be concluded that al-Wakalah is a form of agreement in which a person delegate authority to another to carry out a task on behalf.

The principles of Wakalah applied in the Islamic REIT, whereby the trustee act in a fiduciary role for the benefit of shareholders in enforcing the terms of the trust indenture on behalf of the shareholders invested in the REIT management company. A trustee holds the underlying properties and ensure that the REIT management company is complying with Malaysia regulations. The interest of the shareholders is protected by the trustee as a representative for capital investment in the REIT management company, in exchange for providing the fiduciary services, the trustee is paid a fee.

Al-Ujr

According to Abdullah and Chee (2010), the principles of al-Ujr defined as a contract with a proposed and known usufruct with a specified and lawful return for any expended work or effort. In the other words, Ujr is the fees or commission that is charged for services that are offered by the third party. Al-Ujr has several pillars that include, Mustajir is the person who hires third for the expended works, the al-Ajir is the third party undertake the assigned task in return for the fees, the al-Amal is the service or task needed to be delivery by the third party and al-Ujrah the fees or payment of service.

In Islamic REIT, the concept of al-Ujr refers to the fees that shareholders pay for the services undertaken by the REIT management company. The REIT management company invests in real estate that require some form of management such as rental collection, property maintenance and addressing issues that arises by the tenants. Therefore, a property manager is appointed by the REIT management company to manage property portfolio takes the responsibility as principles of al-Ujr for return for commission or fees. The property managers manage the property on behalf of shareholders and ensures there is alignment between the portfolio strategy and the goals of the REIT management company.

Musya Properties

Another Islamic principle underneath the Islamic REIT structure is Musya Properties which mean the assets that are jointly owned incapable to dissembling among the respective shareholders (Abdullah & Chee, 2010). Furthermore, the Musya Properties also describes the type of property ownership in which there are many owners, and each owner can deal with a part that is prescribed to them without waiting for the rights of other members as long as there is a rating of the division.

This principle aligns with the concept of Islamic REITs which collected funds from various types of property portfolio then consolidated and held by a REIT management company. Then the property portfolio is distributed to the various shareholders through the shares purchase under the trustee as fiduciary. In the event of the REIT management company liquidation, a portion of the assets under liquidation is given to shareholders based on the percentage of shares held.

Ijarah ʻAin

Another Islamic principle underneath the Islamic REIT structure is Ijarah ʻAin. The word derived from root word means compensation for effort or the usage. On the other hand, it also means sale of usufruct with specified and lawful return or compensation of the usage for house, transportation for vehicle for a fee. The Ijarah ʻAin is an agreement that permits one party (the lessee) to use an asset or property owned by another party (the lessor) for an agreed-upon price over a fixed period. It is a form of asset finance which has the benefit of using assets by renting without the requirements of ownership. The lessee acquires the asset he needs without borrowing on interest and receives the benefits of use while the lessor receives the value of regular rental payments for a specified period plus the residual value of the asset. In the operational matters, the asset acquisition is in full ownership of the lessor and responsibility to maintain assets and administrative affairs. On the other hand, lessee only responsible in the maintenance due to the usage and has to pay rent per agreed.

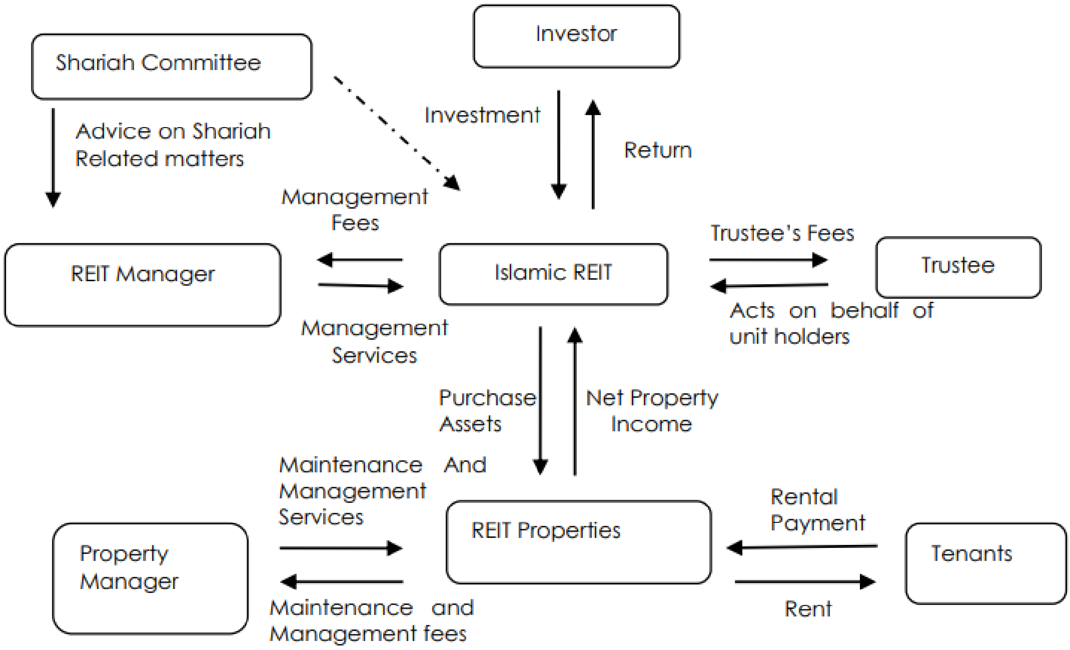
The main businesses of Islamic REIT are to buy and manage real estate portfolio for the purpose of generating profits from rental collection. REITs generate income from rental and 90 percent of that taxable income be distributed to the shareholders on a regular basis as dividend. Therefore, the principles of Ijarah ʻAin impart in the Islamic REIT structure whereby the real estate portfolio are the assets to be leased or renting to the tenant known as lessee and Islamic REIT management company act as lessor. In Ijarah ʻAin an agreement, the lessee receives the benefits of use the real estate while the lessor receives the value of regular rental payments for a specified period. The regular payment would be the income generated by Islamic REIT management company and shared among the shareholders as return.

5. Conceptual Model and Practice of Islamic Real Estate Investment Trusts

As a concept of international finance, securitization will have crucial significance in the future. Securitization refers to the process where homogeneous illiquid financial assets are pooled and packaged into sellable securities to investors. Securitization results into the creation of a Special Purpose Vehicle (SPV), a financial entity that is secured by an asset that produces income or pool of assets and therefore representing certain ownership interests. The securing of the assets is usually done using property either real property, sometimes using a consumer loan or an unsecured credit card. The property may include real estate, automobile or equipment loan. The securitization process involves four major steps as in the Figure 1: (1) creation of a SPV; (2) originator sale of asset to SPV; (3) security issuance by SPV and distribution to securities investors; (4) asset payment to the originator from the proceeds of securities sale.

The securitization descriptions, Islamic REIT considered as a share many similarities as encompasses trust shares issuance to the investors and the acquisition and management of real estate assets through the pooling of funds from investors. However, Islamic REIT differs from securitization in that it is not an asset-backed securitized loan, but it is a real estate asset fund investment. The negative correlation between real estate and other financial investment saw REIT gain a lot of recognition as an investment diversifier (Pavlov et al., 2018). The growing Islamic REITs create an awareness of the property investors from international, it shows the need of developing a better and innovative performance analysis to cater for the need of Islamic market players. The product and opportunities need further innovative development to identify an enhanced property portfolio diversification benefits as well as the fulfilment of the regulation required to hold the Islamic securities. In Figure 1 are the general conceptual model of Islamic REIT Malaysia, with the various parties involved in the structure playing roles of enhancing the framework.

Figure 1: Malaysia Islamic real estate investment trust structure



Sources: Saeed, M. (2011). The outlook for Islamic REITs as an investment vehicle, Lancaster University Management University.

6. Malaysia Real Estate Investment Trust Regulatory Framework

In an effort to accelerate the growth of REIT, the security commission of Malaysia released its guidelines on REITs in 2002 and subsequently on 2005 for Islamic REIT. The guidelines were also targeted at establishing a real estate sector that is not only vibrant but competitive in Malaysia REIT market. The new REIT guidelines substituted the earlier guidelines released on property trust funds on the November 2002. Property trust funds were rebranded into REITs, a term that is used in the world to describe funds whose primary investment is real estate. This rebranding acted as an important boost for the Malaysian investment management industry as well as the real estate sectors. The REIT Guidelines had the following key features, it relaxed the acquisitions of leasehold properties, liberalized REIT of borrowings limits and accorded some form of flexibility to acquisitions of real estates with financial charges. The guidelines also established a uniform regulatory framework for the fund management industry in line with the recommendations of the Capital Market Masterplan 1 (2001–2010) Malaysia blueprint by security commission of Malaysia. Moreover, eligibility requirements for companies involved in the management of REIT such as foreign equity participation and business scope were also aligned with those of companies involved in the management of unit trusts.

The revision of the REIT guidelines was targeted at attracting new players and raising awareness among the local players and property owners in the industry about the benefits of establishing a REIT. Investors get an alternative investment opportunity from a competitive, vibrant and active REIT industry, which also comes with the benefit of higher and improved liquidity in the property market. This move by the security commission of Malaysia was aimed at facilitating an enhanced development of the investment management industry while providing complementary support to the government objective of enhancing the contribution of the real estate sector to the economy as illustrated in the 2004 and 2005 budget that provided tax incentives.

In November 2005, the security commission of Malaysia issued guidelines on Islamic REIT with the objective of stimulating the further development of Malaysia REIT market. These guidelines became the first in the world and therefore Malaysia set a global standard for the establishment and development of Islamic REIT, Therefore, with the guidelines, the role of Islamic REITs in complementing the conventional REIT was enhanced. The Islamic REIT guidelines complemented the conventional REIT guidelines issued in 2002. In line with, the guideline spelled that any investor who wishes to establish Islamic REIT must adhere to these guidelines in addition to conventional REIT guidelines.

The shariah parameters provided in the guidelines on Islamic REITs in acquiring new assets with existing tenant occupying, an appointed shariah committee/shariah adviser must conduct assessments on the property to ensure shariah-compliance before it is acquired by the REIT management company. The activities of the tenants must also be ascertained as permissible, if the tenants operating some non-permissible activities, the returns should not exceed 20 percent of the total rental collection and to acquire any property whose operations are 100 percent non-compliant with the shariah law are non-permitted. On the other hand, for new tenants whose activities are fully non-permissible, the shariah committee/shariah adviser should advise the Islamic REIT manager not to accept such tenants as part of the operational in the property. On the issue pertaining to the continuous rental, the tenant whose activities are non-permissible are of maximum of 20 percent. In terms of mixed activities, the ratio of area occupied for non-permissible activities to the total area occupied will be put into consideration. The following rental activities are considered non-permissible; gambling, share trading or stockbroking in non-sharia compliant securities, Sale and manufacturing of haram products, conventional insurance companies, financial Institutions charging interest on financial products. In term of financing, investment and deposit facilities, REIT management company must comply with shariah principles. In insuring its properties portfolio, Islamic REITs must engage on Islamic compliant such as takaful. In the event, takaful is unavailable, the Islamic REIT, with the permission of shariah advisors, should use conventional forms of insurance. Furthermore, Islamic REITs are allowed to purchase currencies and participate in forward sales, conducting such transactions with Islamic financial institutions is highly encouraged. However, the Islamic REIT can engage with conventional finance institutions with permission from its shariah advisers. The security commission of Malaysia empowered to govern the Islamic REIT with enforcement legislation granted and investigate under the Securities Commission Act 1993, amendment 3 October 2011, a statutory body that govern the Malaysia capital market activates. The key legislation governance of operational and registration issue pertaining to Islamic REIT in Malaysia as follow:

1) Guideline on the Real Estate Investment Trust issued 3 January 2005, revised on 21 August 2008 and updated on 13 July 2011 – aim providing regulatory environment that protect an interest of investors and facilitating on the operational matter on REIT.

2) Guideline on the Islamic Real Estate Investment Trust issued 21 November 2005 – regulate on the Islamic REIT issued pertaining to the shariah compliant and operational matter such as acquiring assets, takaful, investment and deposit.
3) Guideline on Compliance Function for Fund Manager issued on 15 March 2005, 4th revision 9 March 2017- Code of conduct pertaining to the person who manage, establishing, carry out portfolio fund management activities in Malaysia.
4) Security industry act 1983, revised 5 January 2004 – Code of conduct pertaining to the information regards to listed securities.
5) Capital Markets and Services Act 2007, amendment 28 December 2012 – regards to the regulation on the funds raising activities from public.
6) Finance act 2004, updated 1 January 2006 – Regulate on the real property gain tax and stamp duty on the Islamic REIT property portfolio.
7) Listing requirement on Bursa Malaysia Securities Bhd – a set of rule and regulation that the Islamic REIT to be fulfilled before allowed to be listed.
8) Guideline on Assets Valuation issued on 8 May 2009, revised 19 January 2017 – the guideline intended to assist Islamic REIT management and trustee the information's to provide to valuers in preparing the real estate valuation report.
9) Income Tax Act 1967, amendment 1 January 2006 - Regulate on the Islamic REIT company income chargeable on the profit before tax.

7. Conclusion

This achievement put Malaysia on the global leadership in terms of the development of Islamic capital market and financial products and will be key in the promotion and acceleration of growth of the highly competitive Islamic capital markets in Malaysia. The economic development of Malaysia property trust funds specially on the Islamic REIT has been significantly boosted by the improvement of Islamic finance witnessed in recent years. Nonetheless Malaysia Islamic REIT market remains competitive to drive the economic growth of the country and the property sectors. The practices and shariah compliance of current fours Islamic REIT are a necessary given attention by researchers to ensure the stability and improvement of Malaysia Islamic REIT market. Therefore, this paper provides a discussion of Islamic finance to set a basis for Malaysian Islamic REIT, the regulatory framework, and conceptual model property trust funds in Malaysia. This review lays a shariah and Islamic principles application Malaysia Islamic REIT for establishing the study relevance, foundation basis and contribution to the Islamic finance literature review.

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