

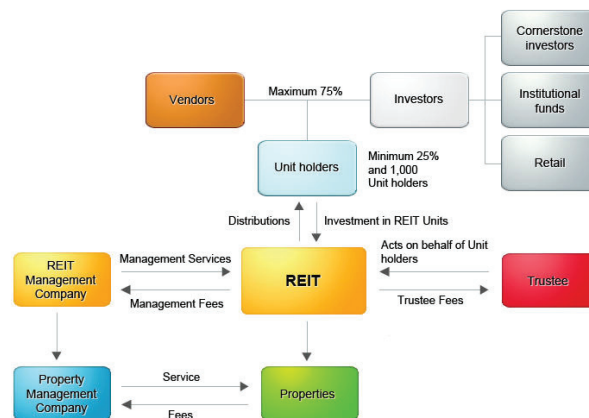
Introduction to REITs in Malaysia

by the Corporate Department

Real estate investment trusts (“REITs”) originated from the US in the 1960s, when then President Dwight D Eisenhower signed into law the REIT Act. It was a new approach to income-producing real estate investment which combines the best attributes of real estate with stock-based investment. It bridged the gap between the average and wealthy investors by enabling the former to tap into investments in large-scale commercial, residential and industrial properties otherwise dominated by large financial intermediaries and wealthy individuals.¹ This idea soon spread to countries outside the US.

The history of REITs in Malaysia can be traced back to two decades ago. It began life as “property trust” with the first listing in 1989 by Amanah Harta Tanah PNB 2, followed by the Arab Malaysian First Property Trust (AMFPT) soon after. “Property trust”, however, never took off in the Malaysian market until its rebranding in 2005 to REITs and Securities Commission Malaysia’s (“SC”) introduction of a guideline to provide a legal framework for better monitoring of the newly introduced REITs.²

Structure of REITs



(Diagram from Bursa Malaysia Securities Berhad website)

REITs in Malaysia are regulated by the SC, which has issued a “Guidelines on Real Estate Investment Trusts” pursuant to s 377 of the Capital Markets and Services Act 2007, or the CMSA (“the Guidelines”). The Guidelines set out two things: the legal requirements for the formation of REITs in Malaysia; and the requirements for issuing, offering or inviting any person to subscribe for or purchase units of the REIT. This article focuses on the former.

REIT is an investment vehicle that pools monies from many investors, much like a mutual fund, for investment in real estate ventures such as apartment complexes, hospitals, office buildings, warehouses and malls, among others. The structure of a Malaysian REIT comprises the following key components — the deed, the assets of the REIT, the trustee, the management company and the unit holders. As a REIT in Malaysia is structured as a trust fund, it is commonly referred to as a “trust” and a “fund”.

1 Richard Stooker, *REITs Around the World: Your Guide to Real Estate Investment Trusts in Nearly 40 Countries for Inflation Protection, Currency Hedging, Risk Management and Diversification* (CreateSpace Independent Publishing Platform, 2011)
 2 Jennifer Chang, “What are Real Estate Investment Trusts (REITs) and how do they fit into your investment portfolio?” (*iProperty* magazine, February 2012) <<http://www.pwc.com/my/en/press/1202-the-rise-of-reits.html>> (accessed 20 November 2016)

The deed

The instrument constituting the fund is the deed, which operates much like the memorandum and articles of association of a company. The deed sets out the creation of the fund or the declaration of trust,³ the appointment of the trustee,⁴ the duties of the management company,⁵ the duties of the trustee,⁶ the joint duties of the management company and the trustee,⁷ and the investment objective of the fund.⁸ The contents of the deed must adhere to the minimum requirements set out in Schedule A of the Guidelines and those specified under securities laws.⁹

The deed will contain full particulars of the fund such as its name, investment objective, the permitted investments, limits and restrictions, the basis for valuation of the assets of the fund, whether the fund has a limited duration, distribution policy, the accounting period of the fund and, if classes of units are issued, a provision specifying the classes, differences between the classes and the rights attached to each class of the units.¹⁰

The assets of a REIT

These comprise largely of income-producing real estate. While REITs are allowed to invest in non-real estate-related assets and cash, deposits and money market instruments,¹¹ at least 50% of the fund's total asset value must be invested in real estate and/or single-purpose companies at all times¹² and the fund's investment in non-real estate-related assets and/or cash, deposits and money market instruments is capped at 25% of the fund's total asset value.¹³

The trustee

The trustee is the registered legal owner of the assets and properties in a fund. It is responsible for executing agreements in relation to the acquisition or disposals of, or the exercise of rights attaching to a fund's property.¹⁴ It has custody and control over the fund's property and holds it in trust for the unit holders in accordance with the deed, the Guidelines and securities laws.¹⁵ It will also exercise oversight functions over the operation and management of the fund by the management company to safeguard the interests of the unit holders.¹⁶ To avoid conflict of interest, the trustee is prohibited from holding units or other interests in the fund.¹⁷

A trustee must be appointed for a REIT, and the appointment approved by the SC.¹⁸ In order to qualify for appointment, the trustee must be a trust company registered under the Trust Companies Act 1949 or incorporated under the Public Trust Corporation Act 1995, be registered with the SC and have a minimum issued and paid-up capital of not less than RM500,000.¹⁹

The management company

Often referred to as the "manager", the management company is responsible for the business decisions in a REIT. The management company establishes the REIT, the issues, offers for subscription, makes an invitation to subscribe for or purchase units of the REIT, and operates and administers the REIT.²⁰

3 Guidelines on Real Estate Investment Trusts, Schedule A (8)(a)
 4 Guidelines on Real Estate Investment Trusts, Schedule A (8)(c)
 5 Guidelines on Real Estate Investment Trusts, Schedule A (4)
 6 Guidelines on Real Estate Investment Trusts, Schedule A (6)
 7 Guidelines on Real Estate Investment Trusts, Schedule A (7)
 8 Guidelines on Real Estate Investment Trusts, Schedule A (8)(d)(ii)
 9 Guidelines on Real Estate Investment Trusts, para 7.01
 10 Guidelines on Real Estate Investment Trusts, Schedule A (8)(d)
 11 Guidelines on Real Estate Investment Trusts, para 8.06
 12 Guidelines on Real Estate Investment Trusts, para 8.07
 13 Guidelines on Real Estate Investment Trusts, para 8.08
 14 Guidelines on Real Estate Investment Trusts, para 4.16
 15 Guidelines on Real Estate Investment Trusts, para 4.07
 16 Guidelines on Real Estate Investment Trusts, paras 4.09 – 4.13
 17 Guidelines on Real Estate Investment Trusts, para 4.22
 18 Capital Markets and Services Act 2007, ss 288(1)(a) and 289(1)
 19 Guidelines on Real Estate Investment Trusts, para 4.02
 20 Guidelines on Real Estate Investment Trusts, para 3.02

The management company must be approved by the SC. It must be an entity incorporated in Malaysia and (except where licensed by the SC) be either a subsidiary of a company involved in the financial services industry in Malaysia or a property development company or a property investment holding company or any other institution which the SC may permit. In addition, it must also have a minimum of 30% local equity and a minimum shareholders' fund of RM1 million at all times.²¹

The unit holders

An investor of REIT is a unit holder of the trust. The key rights of a unit holder include the right to vote at unit holder meetings, the right to an equal and proportionate share in the distributable income of the real estate ventures of the trust and, in the event of liquidation, the right to receive a share of all net cash proceeds in proportion to the interest from the realisation of the assets of the REIT after paying out liabilities.²²

Islamic REITs

Islamic REITs are regulated by the "Guidelines for Islamic Real Estate Investment Trusts",²³ which must be read together with the Guidelines (applicable for conventional REITs). While Islamic REITs operate in much the same way as conventional REITs, the former are required to abide by Shariah principles. In order to ensure that Shariah principles are observed, there is an additional party in the structure of an Islamic REIT, and this is the Shariah committee whose function is to provide advice on Shariah-related matters and to ensure that the operations and activities of the Islamic REIT comply with Shariah principles.

Unlike conventional REITs, Islamic REITs can only invest in real estate whose tenants (or at least the majority of which) operate permissible activities in line with Shariah principles. As such, property transactions in Islamic REITs are screened to limit income from tenants who operate activities deemed unethical such as dealings with alcohol, tobacco, gambling and non-halal food products (such as pork) to not more than 20% of the total revenue.²⁴

Conventional shares and REITs

The difference between conventional shares and REITs is that investors of REITs hold units in a trust and are investing in the returns from the trust, whereas stock investors purchase shares of a company and are investing in the success of the company. There are a wide variety of stocks covering all manner of business sectors, whereas REITs specialise in real estate properties. In the government's effort to promote the REIT industry in Malaysia, REITs enjoy favourable tax treatment over stocks such as exemption from payment of real property gains tax.²⁵

Unit trusts and REITs

The main difference between unit trusts and REITs is that REITs invest predominantly in real estate assets, whereas unit trusts hold a diverse range of asset classes. The total borrowings of a fund in a REIT must not exceed 50% of the total asset value of the fund at the time the borrowings are incurred, unless sanction of the unit holders is obtained while there are no such leverage caps for unit trusts.²⁶ A REIT is fully exempted from tax for a year of assessment if it distributes 90% or more of its total income to its unit holders in the basis period for that year of assessment while there is no similar provision for unit trusts.²⁷ **LH-AG**

21 Guidelines on Real Estate Investment Trusts, para 3.04

22 FAQs on Real Estate Investment Trusts (REITs) of Bursa Malaysia Securities Berhad

23 Issued by the SC on 21 November 2005

24 Guidelines for Islamic Real Estate Investment Trusts, para 1.1(e)

25 Real Property Gains Tax (Exemption) (No 4) Order 2003 [PU(A) 451/2003]

26 Guidelines on Real Estate Investment Trusts, para 8.37

27 Inland Revenue Board of Malaysia's Public Ruling No 2/2015, "Taxation of Real Estate Investment Trust or Property Trust Fund" (19 June 2015) <http://lampiran.hasil.gov.my/pdf/pdfam/PR_2_2015.pdf> (accessed 30 November 2016)