

## Islamic REITs: Implications of Recent Regulatory Changes

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An Islamic real estate investment trust (“REIT”) was previously governed by the provisions of the Securities Commission Malaysia’s Guidelines on Real Estate Investment Trusts,<sup>1</sup> read together with the Guidelines for Islamic Real Estate Investments Trusts<sup>2</sup> (collectively, “Previous Guidelines”).

The Previous Guidelines have since been superseded by the revised Guidelines on Real Estate Investment Trusts (“Revised Guidelines”) in relation to an unlisted REIT,<sup>3</sup> and the Guidelines on Listed Real Estate Investment Trusts (“Listed REIT Guidelines”) in relation to a listed REIT.<sup>4</sup>

### Unlisted Islamic REIT

The requirements applicable to the investments of an unlisted Islamic REIT are now set out under Chapter 18 of the Revised Guidelines, which clarifies the requirements specified in the Previous Guidelines. One notable requirement introduced by the Revised Guidelines is a progressive reduction in the threshold for Shariah non-compliant rental.

In particular, under the Revised Guidelines, an unlisted Islamic REIT is now required by the end of the 10th financial year of its establishment to reduce the percentage of Shariah non-compliant rental from the previous threshold

of less than 20% of the total turnover of the unlisted Islamic REIT (“20% threshold”) to a lower threshold of less than 5% of the total turnover of the unlisted Islamic REIT (“5% threshold”).<sup>5</sup>

The unlisted Islamic REIT must comply with the requirement of reduction to the 5% threshold before it can carry out any of the following exercise:

- (1) acceptance of new tenancy and renewal of existing tenancy of existing tenants whose activities are Shariah non-compliant;<sup>6</sup> and
- (2) acquisition of real estate post-establishment of the unlisted Islamic REIT.<sup>7</sup>

If the unlisted Islamic REIT fails to comply with the requirement to reduce the 20% threshold to the 5% threshold, the excess amount of Shariah non-compliant rental must be channelled to *baitulmal* (i.e. the fund established by the respective Islamic religious department in each state) or charitable bodies as advised by the Shariah adviser within one year from the end of each financial year throughout the years the unlisted Islamic REIT is unable to reduce the Shariah non-compliant rental to less than the 5% threshold.<sup>8</sup>

In addition to changes to the threshold for Shariah non-compliant rental, the Revised Guidelines also deal with other matters relating to an unlisted Islamic REIT, including the following:

1 Issued and revised by the Securities Commission Malaysia (“SC”) in 2012  
 2 Issued by the SC on 21 November 2005  
 3 Revised Guidelines, clauses 1.01A and 1.01B  
 4 Listed REIT Guidelines, clause 1.02  
 5 Revised Guidelines, clause 18.05  
 6 *Ibid*, clauses 18.06 and 18.07  
 7 *Ibid*, clauses 18.09 to 18.12  
 8 *Ibid*, clause 18.12

- (a) provisions relating to the Shariah adviser in clauses 6.08 to 6.12 of the Revised Guidelines, which have been amended to provide more clarity with regard to the requirements on the appointment of a Shariah adviser for an Islamic REIT;
- (b) introduction of a new Chapter 19 on the requirements relating to the conversion of a conventional REIT to an Islamic REIT;
- (c) introduction of a new Chapter 20 on the requirements relating to the application and submission by an Islamic REIT for endorsement of the Shariah Advisory Council of the SC;
- (d) new requirements relating to the contents of the Shariah adviser's report which include a statement on the relevant thresholds for the Shariah non-compliant rental and confirmation that the requirements relating to the threshold have been complied with;<sup>9</sup> and
- (e) new requirements relating to the list of documents required to establish a new Islamic REIT including the Shariah pronouncement by a Shariah adviser providing detailed reasoning or justification supporting the proposed establishment of the Islamic REIT.<sup>10</sup>

### Listed Islamic REIT

The requirements applicable to a listed Islamic REIT are now set out under Part B of the Listed REIT Guidelines, which includes provisions relating to the following:

- (1) appointment of Shariah adviser and its roles and responsibilities;<sup>11</sup>
- (2) additional duties of the management company and trustee;<sup>12</sup>
- (3) investments of the Islamic REIT;<sup>13</sup> and
- (4) conversion of a conventional REIT to an Islamic REIT.

Similar to the requirements applicable to an unlisted Islamic REIT under the Revised Guidelines, there must also be a progressive reduction in the threshold for Shariah non-compliant rental. In particular, the listed Islamic REIT is required by the end of the 10th financial year post-listing to reduce the percentage of Shariah non-compliant rental from the 20% threshold to the 5% threshold.<sup>14</sup> The listed Islamic REIT shall comply with such requirement in order to accept any new tenancy, renew any existing tenancy or to acquire any real estate post-listing.<sup>15</sup> The listed Islamic REIT is required to channel the excess amount of any Shariah non-compliant rental to *baitulmal* or charitable bodies as advised by the Shariah adviser within one year from the end of each financial year, for as long as the listed Islamic REIT is unable to comply with

9 *Ibid*, clauses (16)(b)-(f), (16A), Schedule B

10 *Ibid*, clauses 1(c)(ix)-(x), Appendix I(a), Schedule D

11 Listed REIT Guidelines, Chapter 15

12 *Ibid*, Chapter 16

13 *Ibid*, Chapter 17

14 Listed REIT Guidelines, clause 17.05

15 *Ibid*, clauses 17.06 to 17.09

the requirement to reduce the 20% threshold to the 5% threshold.<sup>16</sup> Consequently, statements and confirmations relating to compliance of the listed Islamic REIT with the reduction to the 5% threshold must be included in the Shariah adviser's report.<sup>17</sup>

To complement the introduction of the Listed REIT Guidelines, the Main Market Listing Requirements have also been amended to enhance the regulatory framework in relation to listed collective investment schemes (which include listed REITs). The amendments to the Main Market Listing Requirements affecting a listed Islamic REIT are related to the details of the Shariah adviser of a listed Islamic REIT to be included in the annual reports of the Islamic REIT.<sup>18</sup> In this regard, the Main Market Listing Requirements provide that the following details of the Shariah adviser must be specified in the annual reports of the listed Islamic REIT:

- (1) name, qualification and experience;
- (2) any conflict of interest that the Shariah adviser has with the listed Islamic REIT; and
- (3) the list of convictions for offences within the past five years (except for traffic offences) and particulars of any public sanction or penalty imposed by the relevant regulatory bodies throughout the financial year. **LH-AG**

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<sup>16</sup> *Ibid*, clause 17.12

<sup>17</sup> *Ibid*, clause 9, Schedule B

<sup>18</sup> Main Market Listing Requirements, clause (6), Part E, Appendix 1