

REGULATORY FRAMEWORK OF REAL ESTATE INVESTMENT TRUSTS IN MALAYSIA

Introduction

Real Estate Investment Trusts (“**REITs**”) have gained prominence on its own as an attractive investment option for investors looking to participate in the real estate sector without owning physical property. In Malaysia, REITs are structured in a way that allows investors to invest in income-generating real estate, such as commercial properties, retail spaces and residential buildings, while enjoying liquidity and diversification.

To ensure transparency, fair play and for the purpose of investors protection, REITs in Malaysia operate under a strict regulatory framework set by various governing bodies. As of July 2024, there are 19 REITs in total that are currently listed on Bursa Malaysia Securities Berhad (“**Bursa Malaysia**”), namely KLCC REIT, IGB REIT, Sunway REIT, Pavilion REIT, AXIS REIT, Al-Aqar HEA REIT, Al-Salam REIT, to name a few, with a total market capitalisation of RM41,780.89 million.[1]

As such, this article explores the regulatory structure governing REITs in Malaysia, focusing on its legal framework, regulatory bodies and compliance requirements.

History and Origin of REITs in Malaysia

The origin of REITs in Malaysia goes back to the year 1989 in which Malaysia became the first country in Asia to permit the formation of Listed Property Trusts (“**LPTs**”) through a legislation.[2] The Arab-Malaysian First Property Trust (AMFPT) was the first LPT to be listed on the Kuala Lumpur Stock Exchange (“**KLSE**”).[3] Towards the end of the 1990s, the number of listed LPTs in Malaysia had grown to four.

The second LPT to be listed on the KLSE was the First Malaysian Property Trust which was listed on 23 November 1989, followed by Amanah Harta Tanah PNB on 28 December 1990 and Maybank Property Trust Fund One on 25 March 1997.[4] As the number of LPTs

in Malaysia continued to grow, the Securities Commission Malaysia (“SC”) introduced a new guideline to govern these trusts in 2005.[5] As a result, the former official term of "Listed Property Trust" was amended to "Real Estate Investment Trust" to align with international standards at that point time.

Classification of REITs in Malaysia

REITs in Malaysia are classified into three main types namely, equity REIT, mortgage REIT and hybrid REIT. Each of these REIT has its own distinct characteristics and investment strategies.[6]

Equity REITs: This REIT primarily invests in and owns commercial real estate properties. Its portfolio typically includes office buildings, shopping complexes, apartment buildings and other types of income-generating properties.[7] Essentially, equity REITs earn revenue through rental income from the properties in their portfolios. One notable example of an equity REIT in Malaysia is the KLCC REIT which consists of iconic properties such as the Petronas Twin Towers, Menara 3 Petronas and Menara ExxonMobil as part of its property portfolio.[8] The usual practice is that equity REITs will distribute at least 90% of their taxable income to shareholders on an annual basis.[9] This distribution is made in the form of dividends, providing investors with a steady income stream. As such, equity REITs have become a highly attractive investment option for investors globally, due to their potential for steady returns and exposure to valuable real estate assets such as the Petronas Twin Towers.

Mortgage REIT: Mortgage REIT focuses on providing financing to real estate owners and developers through mortgage loans or by purchasing mortgage-backed securities.[10] Instead of owning physical properties, mortgage REIT generates income by earning interest on the loans that it provides. The interest payments received from these mortgages are distributed to shareholders as annual dividends. Fundamentally, this model allows mortgage REIT to offer a different type of return to investors which makes it unique as its returns are in a form of interest income rather than rental income. One of the examples of a notable mortgage REIT is the Annaly Capital Management, Inc, one of America's largest mortgage REITs that invests in residential and commercial mortgages. [11]

Hybrid REITs: Hybrid REIT is the combination of both equity and mortgage REITs.[12] This structure invests in real estate properties while providing financing through mortgages at the same time. This dual approach allows hybrid REIT to diversify its investment strategies and income sources. By holding both physical properties and mortgage assets, hybrid REITs are potentially able to manage risk more effectively and offer a blend of rental and interest income to their shareholders, this makes it a compelling investment choice for investors around the world.

Regulatory Bodies

In Malaysia, the business and operation of a REIT is principally regulated by the SC pursuant to the Capital Markets and Services Act 2007 ("**CMSA**"). SC has previously issued guidelines for property trust funds that have been developed and revised several times along with the growth of the REIT market in Malaysia before being replaced by the SC's Guidelines on Listed Real Estate Investment Trusts in 2008 (updated 28 December 2012) ("**REIT Guidelines**"). In addition, regulations pertaining to listed REITs are also outlined in the Main Market Listing Requirements ("**MMLR**"). Therefore, REITs in Malaysia are effectively governed by the CMSA, REIT Guidelines and MMLR.[13]

Bursa Malaysia offers a comprehensive platform for the trading of REITs, where these investment vehicles are listed and transacted. The exchange enforces stringent listing requirements and ensures adherence to rigorous disclosure and reporting standards. SC and Bursa Malaysia collaborate closely in overseeing these processes. Specifically, all REITs seeking to be listed on Bursa Malaysia must obtain approval from the SC in accordance with the CMSA.[14] Bursa Malaysia primarily facilitates investors access to REIT units through accredited stockbrokers, providing a convenient platform for investing in substantial commercial real estate assets. In summary, Bursa Malaysia plays a crucial role in offering the necessary infrastructure, regulatory framework and educational support that underpins the REIT industry's development, enabling investors to engage with this asset class effectively. The prosperous state of REITs in Malaysia today can be attributed to the comprehensive foundation laid by Bursa Malaysia.

Legal and Regulatory Framework of REITs in Malaysia

In Malaysia, the CMSA and REIT Guidelines are the key aspects of the legal and regulatory framework for REITs.

I. Capital Markets and Services Act 2007

The CMSA defines REIT as a collective investment scheme that allocates or intends to allocate capital into a portfolio of real estate and related assets. This definition mandates that REITs must be registered with the SC and adheres to the SC's REIT Guidelines.[15] CMSA on the other hand, provides the foundational legal framework for the establishment, operation and regulation of REITs in Malaysia. It works in conjunction with the SC's guidelines to ensure comprehensive governance and oversight of this investment class. Section 58 of the CMSA requires any person who is carrying out regulated activities to have a capital market services ("**CMSL**") license.[16] Regulated activities are defined under the CMSA, among others, as dealing in securities. Essentially, REITs fall under the definition of dealing in securities. As such, the establishment of REITs require a CMSL license which is usually applied by the REIT manager as the entity who is carrying out the activity of dealing in securities.

II. The Guidelines on Listed Real Estate Investment Trusts

Fundamentally, the key requirements for listed REITs in Malaysia, such as but not limited to the minimum fund size, number of unit holders, public spread requirement and gearing limit are outlined in the REIT Guidelines. Among the key chapters of the REIT Guidelines are as follows:

a. Chapter 12 of the REIT Guidelines: Public Offerings and Listings

To qualify for a primary listing on the Main Market of Bursa Malaysia, a REIT must meet a minimum size requirement of at least RM500 million. In relation to its pricing, the issue price of units offered for subscription or sale, for which a listing is sought, must be at least RM0.50 each. Apart from that, for a listing on the Main Market of Bursa Malaysia, the MMLR requires REITs in Malaysia to comply with a public spread requirement. Paragraph 2.1, Practice Note 19 of the MMLR stipulates that 25% of the total units of a listed REIT must be held by the public.[17] Inherently, these stipulations are designed to ensure a diverse and substantial investor base, enhancing the stability and liquidity of the REIT.[18]

b. Chapter 8 of the REIT Guidelines: Investments of the REIT

Paragraph 8.30 of the REIT Guidelines stipulates that a REIT may only borrow or obtain financing facilities from financial institutions or through the issuance of debt securities or sukuk. Paragraph 8.32 of the REIT Guidelines specify that a REIT's total borrowing or financing including financing through the issuance of debt securities or sukuk should not exceed 50% of its total asset value. This 50% limit is designed to promote prudent financial management and mitigate risks associated with excessive borrowing following from an establishment of a REIT. By imposing this cap, the REIT Guidelines ensure that listed REITs maintain a prudent level of leverage, thereby safeguarding their financial stability and protecting the interests of their unit holders.[19]

Islamic Real Estate Investment Trusts (i-REITS)

In addition to conventional REITs, Malaysia also offers Shariah-compliant Real Estate Investment Trusts known as i-REIT. Similar to conventional REIT, the legal and regulatory framework for i-REIT in Malaysia is primarily established by the SC through the REIT Guidelines with an addition of the Guidelines on Islamic Capital Market Products and Services ("**Islamic Products Guidelines**") which has been issued in 2022 to ensure compliance with Shariah principles together with the CMSA which provides the overall legal framework for i-REITs. The REIT Guidelines, in paragraphs 1.02, 1.02A and 1.03 specifies that the requirements for registration, management and operation of i-REIT must follow Shariah principles stated in the Islamic Products Guidelines.[20]

Although both conventional REITs and i-REITs follow the same regulatory body and guidelines, i-REITs must comply with additional conditions relating to Islamic financial

products. The key differences between the two are primarily rooted in their adherence to Islamic principles.[21] For example, according to paragraph 1 on Chapter 3 of the Islamic Products Guidelines for i-REITS, a Shariah advisor or committee must be appointed to ensure compliance with Shariah principles in all operational matters. Imperatively, according to Chapter 4 of the Islamic Products Guidelines, i-REITs must strictly adhere to Shariah principles, which means that all income must be derived from Shariah-compliant activities.

Formation and Structure of REIT

The key components in a REIT structure are that it must consist of a management company, a trustee and a trust deed governing the structure. The following provides a detailed overview of the structure, aligned with the relevant sections from the REIT Guidelines.

I. Chapter 3 of the REIT Guidelines: Establishment of a Management Company

Paragraph 3.01 of the REIT Guidelines defines management company as the company that establishes a REIT. Primarily, a management company handles the day-to-day operations and investment decisions of a REIT, including property acquisitions, leasing and divestments. An example of a management company is the Pavilion REIT Management Sdn Bhd who manages the Pavilion REIT.[22] Paragraph 3.04 of the REIT Guidelines provides that a management company must consist of at least two independent directors and a minimum of one-third independent directors on the board whereby paragraph 3.06 of the REIT Guidelines outlines the roles and responsibilities of the management company.

In essence, a management company must act with the care and diligence that a reasonable person would in this role and prioritise the interests of unit holders, even when there is a conflict with its own. In furtherance, a management company is also responsible for determining dividend distributions to unit holders and must uphold high standards of integrity and fair dealing in doing so while acting in the best interests of the unit holders.

II. Chapter 7 of the REIT Guidelines: Constitution of a REIT (Trust Deed and Trustee)

A REIT must be established through a trust deed to be entered into by the management company and the trustee to the REIT. The function of a trust deed is to outline the terms and conditions of the REIT, including the roles and responsibilities of the trustee and the management company. The trust deed establishes the legal relationship between the REIT manager, the trustee and the unit holders. It outlines the rights and responsibilities of each party, ensuring that the REIT is managed in accordance with the specified objectives and principles. This includes stipulating how the REIT manager should operate, the investment strategies to be employed and the obligations of the trustee to safeguard the interests of the unit holders.[23]

Additionally, the trust deed outlines how the REIT's assets should be managed, including rules for investment limits, buying and selling properties, and how income will be distributed to unit holders. It also explains the details on procedures for meetings, unit holder voting rights and the conditions under which a REIT can be dissolved. By the establishment of a clear framework for operations, the trust deed ensures that the REIT complies with applicable laws and regulations in order to promote transparency and accountability.[24]

The role of a trustee in a REIT is to act as the custodian of the REIT's assets as most of the time the legal ownership of such assets is vested in the trustee. The role of a custodian is to ensure that the properties under a REIT are managed in accordance with the trust deed and applicable laws and regulations. Apart from that, trustee to a REIT safeguards the interests of unit holders by overseeing the actions of the management company, ensuring compliance with applicable laws while protecting the rights of unit holders. This independent oversight is vital for maintaining investor confidence and ensuring transparency in the management of the REIT.[25]

Conclusion

In conclusion, the development of REITs in Malaysia has provided a valuable investment avenue for both retail and institutional investors, enabling access to income-generating real estates. The regulatory framework, primarily guided by the SC through the CMSA and REIT Guidelines, ensures that REITs operate with transparency, fairness and adherence to established financial and operational standards. With the option of both conventional and Shariah-compliant REITs, the Malaysian REIT market caters to a broad spectrum of investor needs, further enhancing its appeal. The comprehensive legal and regulatory structure, along with oversight from key bodies like Bursa Malaysia, fosters a stable and growing environment for REITs, solidifying their position as an integral part of Malaysia's investment landscape.

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Written by:



Chempaka Nur Camelia Mohd Nafizi
Associate
chempaka.camelia@azmilaw.com



Sharifah Lyana Syed Muhammad Muzakir
Legal Executive
sharifah.lyana@azmilaw.com

Corporate Communications

Azmi & Associates

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